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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959

No. 513

UNITED STATES, PETITIONER,

vs.

CANNELTON SEWER PIPE COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED NOVEMBER 4, 1959

CERTIORARI GRANTED DECEMBER 14, 1959

SUPREME COURT OF THE UNITED STATES

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CANNELTON SEWER PIPE COMPANY

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[fol. a]

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

CANNELTON SEWER PIPE COMPANY, Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA, Defendant-Appellant

On Appeal from the Judgment of the United States District Court for the Southern District of Indiana

Appendix to Brief for the Appellant

[fol. 1] IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF INDIANA, INDIANAPOLIS DIVISION

No. IP-57-C-163

CANNELTON SEWER PIPE COMPANY, a Corporation,

vs.

UNITED STATES OF AMERICA

DOCKET ENTRIES

6-28-57 Complaint filed. Summons issued. Also files Cost Bond with U.S. Fidelity & Guaranty Co. as surety thereon.

7-9-57 U. S. Marshal returns summons. Served July 2, 1957.

8-27-57 U. S. Attorney files Answer to Plaintiff's complaint, with proof of service.

12-23-57 Assigned for pre-trial conference on Tuesday, January 7, 1958 at 3:00 P.M. (SE)

Assigned for trial on January 13, 1958. (SE)

1-7-58 Pre-trial Conference held. Counsel to prepare entry.

1-31-58 Assigned for Court trial Tuesday, March 11, 1958 at 9:30 A.M. (SE)

DOCKET ENTRIES—Continued

2-12-58 Court enters pre-trial order of conference held on January 7, 1958; cause ordered set for trial in March 1958 and trial briefs to be filed one week before trial date. (SE) Copies mailed.

2-20-58 Parties file Stipulation of Facts No. 1.

3-3-58 Government files Notice of taking of Deposition, with acknowledgment of service.

[fol. 2] 3-3-58 Plaintiff files Pre-trial Memorandum-brief, with proof of mailing.

3-5-58 Defendant files pre-trial brief.

3-7-58 U. S. Attorney files certificate of mailing of Pre-trial brief filed March 5, 1958.

3-11-58 Court trial commenced. Opening statements made. Evidence on behalf of plaintiff is heard in part. Some evidence on behalf of defendant heard in part. Hour for adjournment having arrived, Court is adjourned until tomorrow at 9:30 A. M. (SE)

3-12-58 Trial resumed. Additional evidence on behalf of plaintiff and defendant heard and concluded. No rebuttal evidence offered. Court continues this matter for briefing and final argument. Court grants plaintiff three weeks after receipt of transcript to file post trial brief. Defendant granted ten days thereafter to file answer brief, and plaintiff ten days thereafter to file reply brief. Parties to submit proposed Findings of Fact and Conclusions of Law, and entry. Court adjourned. (SE)

4-14-58 Plaintiff files Post Trial Brief, with proof of service.

4-28-58 U. S. files its post trial brief, with proof of service.

5-7-58 Plaintiff files Reply Brief with proof of service.

Plaintiff submits proposed Findings of Fact and Conclusions of Law.

6-19-58 Assigned for Final Argument on Wednesday, June 25, 1958 at 2:00 P.M. (SE)

6-23-58 Parties file Stipulation, waiving argument and submitting cause.

6-25-58 Court files its Findings of Fact and Conclusions of Law. Court enters order that Plaintiff recover of and from the defendant the sum of $79,280.01 together with all [fol. 3] costs of this proceeding and second cause of action is hereby dismissed. (SE) Copy to attorneys.

DOCKET ENTRIES—Continued

8-22-58 United States Attorney files Notice of Appeal.

9-25-58 Government, Defendant-Appellant, files Motion for extension of time within which to file and Docket Record on Appeal, with proof of service.

9-26-58 Court grants Government's Motion for extension of time within which to file and docket record on appeal. Time extended an additional 50 days. (SE)

IN UNITED STATES DISTRICT COURT

FINDINGS OF FACTS AND CONCLUSIONS OF LAW—Filed June 25, 1958

The above entitled cause came on for trial to the Court. The evidence was heard on March 11, and 12, 1958, concluded and continued for briefing and final argument thereafter. The briefs were filed as follows: plaintiff's on April 14, 1958; defendant's answer brief on April 28, 1958; and plaintiff's reply briefs on May 7, and 14, 1958. The matter was set for final argument for June 25, 1958 and the parties in writing waived final argument on June 24, 1958.

The Court having duly considered the evidence and being fully advised in the premises now finds the following:

FINDINGS OF FACTS

1. The defendant admits by its answer all of the jurisdictional allegations of plaintiff's complaint as to the Court's jurisdiction of the persons and subject matter. These facts will not be repeated but the allegations of the pleadings pertaining thereto are adopted herein by reference.

[fol. 4] 2. The plaintiff paid to the defendant at the office of its Indianapolis Collector of Internal Revenue the following taxes which are in issue:

A. Excess profits tax for the fiscal year ending November 30, 1950 in the amount of $3,487.72 plus interest thereon of $25.78 on the following dates:

October 31, 1951	$3,363.15;
September 2, 1954	$ 124.57; and
September 2, 1954	$ 25.78.

B. Income tax for the fiscal year ending November 30, 1951 in the amount of $53,649.93 plus interest on a part thereof of $3,911.85 on the following dates:

May 13, 1951	$16,825.56;
July 13, 1954	$36,824.37; and
July 13, 1954	$ 3,911.85.

3. The defendant admits by its answer that plaintiff duly filed with said collector various amended returns and claims for refund for the said tax payments and interest all as alleged in plaintiff's complaint. These facts will not be repeated but the allegations of the pleadings pertaining thereto are adopted herein by reference.

4. The defendant admits by its answer that it disallowed all of plaintiff's claims for refund of said tax payments and interest all as alleged in plaintiff's complaint. These facts will not be repeated but the allegations of the pleadings pertaining thereto are adopted herein by reference.

5. All of the admitted allegations of plaintiff's complaint by defendant's answer are adopted herein by reference.

6. The plaintiff is a corporation organized under the laws of the State of Indiana, having its principal place [fol. 5] of business in the City of Cannelton, Perry County, Indiana.

7. During the tax years in question the plaintiff was engaged in the business of mining fire clay and shale from an underground mine owned and operated by it; transporting the minerals in trucks a distance of 1.5 miles to a plant owned and operated by it in Cannelton, Indiana; where it used said minerals in producing vitrified sewer pipe, flue lining and related vitrified products; and which products were sold by plaintiff to various purchasers in the Central United States.

8. The clay and shale referred to in item 7 were adjacent strata deposits beneath a thin vein of coal.

The clay was a "refractory or fire clay" having a pyrometric cone equivalent of 19 to 26.

The proportions in which plaintiff mined and used the fire clay and shale were 60% fire clay and 40% shale.

9. All of said fire clay and shale mined by plaintiff during said time was used by plaintiff in producing said prod-

ucts, except for the sale of approximately 80 tons of ground fire clay and shale in bags for a total price of $1822.45, or an average price of $22.88 per ton.

During plaintiff's fiscal year ending November 30, 1951, plaintiff mined a total of 38,473 tons of fire clay and shale, and plaintiff's net sales of manufactured products in such fiscal year amounted to $1,409,145.66.

10. All of the processes used and applied by plaintiff to the fire clay and shale which it mined and used, were processes normally applied by mine owners or operators who are engaged in the manufacture of vitrified clay sewer pipe and related products.

11. Plaintiff has never sold any of its raw fire clay or shale and has never purchased any fire clay or shale for use in its production of said products.

[fol. 6] 12. There was no market for the fire clay and shale mined by plaintiff before it was processed into said products, except for negligible amounts of fire clay and shale sold in bags.

13. The first "commercially marketable mineral product" of the fire clay and shale mined by plaintiff during the years in question was the said finished products.

14. The plaintiff for its fiscal year ending November 30, 1950 had an excess profits net income of $191,689.06 with an excess profits credit of $142,227.24.

The plaintiff is entitled to carry back to the fiscal year ending November 30, 1950 the unused excess profits credit from the fiscal year ending November 30, 1951 in the amount of $31,446.31. This is because of the depletion allowance to which plaintiff is entitled for the fiscal year ending November 30, 1951 which results in a reduction of plaintiff's excess profits net income for such year to $110,780.93.

This amount of unused excess profits credit, being greater than the adjusted excess profits net income for the fiscal year ending November 30, 1950, results that the plaintiff had no adjusted excess profits net income for its fiscal year ending November 30, 1950 and owed no excess profits tax for such year and has overpaid in the sum of $3,513.50.

15. The plaintiff is entitled to a deduction for depletion for the fiscal year ending November 30, 1951 in the amount of $88,908.13, and plaintiff was liable for income and ex-

cess profits taxes for such fiscal year in the amount of $51,141.07 and has paid an additional sum of $57,561.78.

Conclusion of Law

7. The Court has jurisdiction of the persons and subject matter of this action.

[fol. 7] 2. The law is with the plaintiff and against the defendant on the issues of the first cause of action and the answer thereto.

The law is against the plaintiff and for the defendant on the issues of the second cause of action and the answer thereto in so far as it conflicts with the first cause of action and answer thereto.

3. Plaintiff's processing of the mined minerals during the years in question were the ordinary treatment processes normally applied by mine owners and operators in order to produce the commercially marketable mineral products within the meaning of Section 114(b)(4)(B) of the Internal Revenue Code of 1939, as amended.

4. Plaintiff's "gross income from the property" is plaintiff's net sales (F.O.B. its plant, loaded for shipment) of the finished products from said minerals.

5. Plaintiff is entitled to a deduction for depletion during its fiscal years equal to 15% of 60% of its "gross income from the property", and 5% of 40% of its "gross income from the property", limited to 50% of its "net income (computed without allowance for depletion) from the property.

6. Plaintiff has overpaid its excess profits tax for the fiscal year ending November 30, 1950 in the total sum of $3,513.50.

Plaintiff is entitled to recover such sum of $3,513.50 from the defendant together with interest thereon at the rate of 6% per annum on the following amounts and from the following dates to the date of judgment herein:

on $3,363.15 from October 31, 1951; and
on $ 150.35 from September 2, 1954.

Total $3,513.50 principal.

[fol. 8] 7. Plaintiff has overpaid its income tax for the fiscal year ending November 30, 1951 in the total sum of $57,561.78.

Plaintiff is entitled to recover such sum of $57,561.78 from the defendant, together with interest thereon at the rate of 6% per annum on the following amounts and from the following dates to the date of judgment herein:

on $16,825.56 from May 13, 1951;
and on $40,736.22 from July 13, 1954.

8. The second cause of action should be dismissed.

The Clerk is directed to enter judgment in accordance with these findings of facts and conclusions of law and the plaintiff is awarded its costs taxed by the Clerk in the sum of $———.

Dated this 25 day of June, 1958.

(S.) Cale J. Holder, Judge, United States District Court, Southern District of Indiana.

IN UNITED STATES DISTRICT COURT

JUDGMENT ENTRY—JUNE 25, 1958

The Court having filed its Findings of Facts and Conclusions of Law and Order for Judgment:

Now, therefore, pursuant thereto, IT IS ADJUDGED, that the plaintiff recover from the defendant the sum of $79,280.01 together with all costs of this proceeding taxed by the Clerk in the sum of $———.

It is Further Ordered, that the second cause of action be and it is dismissed.

Dated this 25 day of June, 1958.

(S.) Cale J. Holder, Judge, United States District Court, Southern District of Indiana.

[fol. 9] IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL—Filed Aug. 22, 1958

Notice is hereby given that the United States of America, the above named defendant, hereby appeals to the United States Court of Appeals for the Seventh Circuit from the final judgment of this Court entered in this action on June 25, 1958.

Don A. Tabbert, United States Attorney, by: (S) Philip R. Melangton, Jr., Assistant United States Attorney.

[fol. 10] IN UNITED STATES DISTRICT COURT

Transcript of Testimony

APPEARANCES

The plaintiff appeared by and through its counsel, Royse & Travis, by Howard P. Travis and Thomas A. Hendrickson.

The defendant appeared by and through its counsel, Ernest C. Friesen, Jr., Department of Justice, Washington, D. C., and John C. Vandivier, Assistant United States Attorney.

Be it Remembered, That in the United States District Court for the Southern District of Indiana, Indianapolis Division, at the United States Court House in the city of Indianapolis, Indiana, on the 11th day of March, 1958, at 9:45 o'clock a.m., the above-entitled cause being at issue came on for trial before the Honorable Cale J. Holder, Judge of the said Court, and the proceedings upon the trial are in the words and figures following, to-wit:

COLLOQUY BETWEEN COURT AND COUNSEL

The Court: Will the Clerk call the case, please.

The Clerk: Indianapolis 57-C-163; Cannelton Sewer Pipe Company versus United States of America.

Mr. Travis: (For Pltf.) The plaintiff is ready, your Honor.

Mr. Friesen: (For Deft.) The defendant is ready, your Honor.

The Court: Yes, Mr. Vandivier.

Mr. Vandivier: (For Deft.) May it please the Court, I would like to introduce, or reintroduce Mr. Ernest C. Friesen, of the Department of Justice, Washington, D. C., who is head counsel and will try the Government's side of the case. This is Mr. John Stafford, with the Internal Revenue Service of Cleveland, Ohio, who will be at the table with Mr. Ernest Friesen. I, myself, your Honor, will be in [fol. 11] and out, if I may have the Court's permission, inasmuch as I will not be needed at all by Mr. Friesen.

The Court: All right. Do you want to introduce your parties?

Mr. Travis: (For Pltf.) I would like to have you know Mr. Thomas Hendrickson, who is a partner in our firm.

The Court: Are you prepared for opening statements? Have you talked to counsel on the other side?

Mr. Travis: (For Pltf.) I think, your Honor, there may be a slight misunderstanding now as to what the Court told us yesterday. I repeat again I had an expert witness on clay mineralogy who was coming here from the Ceramic Engineering Department of Ohio State University. Unfortunately he is involved at the present time with a funeral in his family, and reported to us Sunday that he would not be able to be here. Yesterday I appeared with Mr. Vandivier before your Honor and requested that the case be continued for that purpose, and my understanding of the Court's suggestion, which both sides agreed to, was that the plaintiff would proceed with its case except for Dr. Everhart, who is the witness I referred to, and that the defendant would then enter its case, and then the case would be continued for two purposes, as I understood: one, to receive the testimony of Dr. Everhart at a later date; and secondly, for the plaintiff to enter its rebuttal to the Government's defense today.

The Court: First, their defense to that expert's testimony.

Mr. Travis: (For Plff.) And that the Government would have an opportunity to answer anything Dr. Everhart testified to.

The Court: Is that your understanding, Mr. Vandivier? [fol. 12] Mr. Vandivier: (For Deft.) That is my understanding. The only point I believe we may have disagreed on: there was not any set time the plaintiff and defendant would finish today, necessarily, but the method of procedure inasmuch as Dr. Everhart could not be present.

The Court: Is that agreeable to you, sir?

Mr. Friesen: (For Deft.) Yes, your Honor, as long as there is some latitude in a technical case like this in rebutting or showing from Dr. Everhart's testimony that the Government's position is correct.

I have talked to Dr. Everhart, and I would be as happy as they are to have him testify. I believe he is a very well qualified expert; however, gathering the information upon

which the expert testimony is based may require further testimony as to what products are actually produced in the surrounding area, and we may need to call persons to testify as to sales of certain types of material after this testimony is completed.

The Court: Well, as I understood the arrangement, upon receipt of the expert's testimony at some future date the Government would have the full opportunity to offer any evidence in defense of that particular subject. We don't have a jury here, and we can exercise some discretion and latitude, both sides.

Mr. Travis: (For Pltf.) Your Honor, the thing I am a little concerned on this resumption of trial is during the interval, while the case is continued, I will wish to rebut the Government's case to the best of our ability with evidence. It wasn't my understanding, and I would not wish it to be so, at that time the Government can still come in with some evidence on this marketability, which we then would also not know about at that time.

Mr. Friesen: (For Deft.) If the Court please, I showed to [fol. 13] Mr. Travis this morning the affidavits of some further information that I wanted to present in affidavit form. Mr. Travis properly wants to cross-examine those persons. I do not anticipate further evidence of marketability will be necessary unless Dr. Everhart states this particular material is of some special kind, in which case we will need to bring in special witnesses.

The Court: The Court understands sometimes we can not plan the whole thing out completely, and we are going to have to decide at the time when the issue comes up. Generally we are in agreement on the subject that the expert witness's testimony can be offered at some other time. The Government will have an opportunity to respond to that with some evidence to meet that and rebuttal and surrebuttal will be at some future date.

Mr. Travis: (For Pltf.) I think, your Honor, there is a lawyer I would like to present. Judge, this is Jerry Luptak, attorney from Detroit, Michigan, who is here as an observer and is interested because he has similar cases.

The Court: You are not participating in this case?

Mr. Luptak: No.

OPENING STATEMENT OF MR. TRAVIS

Mr. Travis: (For Pltf.) Your Honor is somewhat familiar with the issues before the Court because of the pre-trial conference which was held in January and briefs which each side has filed since. I will make a short opening statement and simplify those issues as they are before the Court today.

The question involved is the amount of the allowance for depletion to which the plaintiff is entitled in computing the income tax for the fiscal year ending November 30, 1951, because of the mining by it and the use by it in manufacturing of clay and shale, which I will call fire clay and shale, and the Government will call clay and shale.

[fol. 14] The applicable provisions of the Internal Revenue Code of 1939, which apply in this case are this: That any taxpayer engaged in mining, in this instance fire clay and shale, is entitled to a deduction from its gross income in computing its net income for tax purposes of an amount equal to 15 per cent in the case of fire clay, and 5 per cent in the case of shale, of the gross income from mining.

Mining is further defined in the statute as meaning not merely the extraction of the minerals from the ground, which we normally think of in mining, but is also to include any processes applied by the mine owners and operators normally in order to produce a commercially marketable product.

Many cases have been tried over the country to define what we mean by "gross income from mining" and what we—what the statute means Congress meant by "a commercially marketable product." Those cases resulted in various appeals and decisions by four Circuit Courts of Appeals and the Tax Court all in favor of the taxpayer on the theory that the taxpayer was entitled to apply the percentages for depletion purposes to the net sales of its manufactured products loaded and ready for shipment. Those cases, some of the representative ones, were then joined by the Government in a petition for certiorari in the Supreme Court, and that petition was denied last October. That was the end of the theory of the Government, which was being used in those cases to the effect that the finished brick or sewer pipe, both of which were involved in those appeals, were not mineral products, and that, therefore, you had to go to some prior step in the manufacturing process and cut

it off and find out what your costs were at that point. So, we have no question here that sewer pipe is a mineral product within the meaning of the statute.

At the pre-trial conference, which was held before your [fol. 15] Honor, the Government stated that the issues which would be contested in this case, being different from any case which has ever been tried before, would be in relation to the marketability of some product prior to a piece of sewer pipe in the Canmelton Area where the plaintiff's plant is located, and that if they were successful in showing such a market, it would be necesary, of course, to inquire into the representative market price for that earlier product.

I assume from conferences with counsel for the Government that the earlier product to which they refer is raw clay as it is scooped out of the mine. On that issue we will show that no clay of the type suitable for manufacturing vitrified sewer pipe is now, or has been, sold in the Canmelton Area; that the plaintiff has never sold clay as such; that the plaintiff has never purchased clay as such. It has been until this very day either mining its own clay with its own machinery and manpower, or it has contracted with someone else to mine that clay and haul it to its plant for stipulated prices per ton on land in which the plaintiff had an economic interest.

The plaintiff will also show that it can not, by virtue of the economics of its manufacturing processes, afford to buy clay and have it hauled to its mine have it hauled to its plant in any distance farther than 10 to 12 miles; that the rates for hauling are prohibitive; that the product is a low gross margin product; that the clay, itself, is a considerable factor in the price which the plaintiff must receive for that product, and, therefore, the clay which the plaintiff uses must of necessity be a very cheap, laid-down cost to it.

After the pre-trial conference, and when counsel were negotiating together on a stipulation of facts, the Government for the first time stated that it would raise and contest another issue of fact. That issue is that the Government [fol. 16] will now apparently attempt to contest the fact that the clay as distinguished from shale, which the plaintiff used in the fiscal Year, 1951, was in fact not fire clay. On that issue there will be introduced in evidence by the plaintiff a deposition, taken last Saturday, of Dr. Haydn H. Murray, who was formerly head of the Indiana Geological

Survey for seven years, who is probably the outstanding authority in the entire United States on clays, and plants using clays, in the State of Indiana. In addition to that the plaintiff will have Mr. Eugene Clemens, an officer of the plaintiff, who has devoted his life similarly to clay mineralogy. The plaintiff will also, depending upon the defendant's evidence I might say, introduce the testimony of Dr. J. O. Everhart, who is the head of the Ceramic Engineering Department at Ohio State University, and who also is one of the few recognized clay mineralogists in the entire country.

What evidence the defendant intends to introduce on the question of fire clay I do not know, and I can't conceive.

In the Government's brief counsel referred, in discussing the regulations of the Treasury Department regarding this question, to that more or less general part of these regulations regarding cases where a mineral is not sold at the mine head or oil head such as an oil is. And the regulation has been in force for some years, and it states simply that where there is no selling price, but there is a market at the well head or mine head, then we must look for a representative market or field price to find the value of the clay for the purposes of depletion. That regulation is all well and good as far as it goes; but fire clay was added as a mineral subject to percentage of depletion in the Internal Revenue Code in 1950, effective January 1, 1951. For seven years the Internal Revenue Service has labored with the problem [fol. 17] of what is fire clay. During that time they have had the benefit of experts' advice, definitions, and other, from all over the country, all industries using fire and refractory products. At two places during this seven years they have come out with a definition. The first in 1954 was a simple and easy application. It stated that fire clay would be considered a fire clay if it had a solid pyrometric cone equivalent of 15 or higher. That regulation continued in effect for a couple of years and, perhaps due to loss of revenue and because of the simplicity of the regulation, the Internal Revenue Service issued a new regulation on fire clay, revoking the prior one. This regulation is denominated "Revenue Ruling 56-59," and in this regulation the Service abandoned the pyrometric cone equivalent test as a test for fire clay and, instead, substituted a test relating to the use to which the clay was put. If it was used for a

refractory purpose, then it would be considered fire clay within the meaning of the Code. And the regulation went on to state briefly what it meant by "refractory purpose"; and one of those purposes contained in the regulation stated this:

> "It is recognized that under certain circumstances fire clay may be used in conjunction with ordinary clay and still be used for refractory purposes, such as when certain amount of fire clay is blended with ordinary clay in order to produce the vitrified clay sewer pipe."

Again reading:

> "Clay used or sold for use as a refractory clay entitled to 15 per cent depletion."

Again reading:

> "Fire clay is used to enable sewer pipe to retain its shape and dimensions under extremely higher tempera- [fol. 18] ture required for vitrification is considered to be used as refractory clay."

That regulation is, so far as Treasury Regulations are the law, the law today. That is the regulation that is in force at this moment, and it states in unmistakable terms that fire clay used to add strength and other properties to sewer pipe is a refractory clay, and is entitled to 15 per cent depletion.

The plaintiff, under both definitions that have been issued by the Treasury Department on this subject, falls clearly within the definition of fire clay and is entitled to the 15 per cent depletion rate. Because of the unavailability of those regulations, I would like to have the Court have this one which is the Treasury Regulation.

Thank you, your Honor.

The Court: Mr. Friesen.

Opening Statement of Mr. Friesen

Mr. Friesen: (For Deft.) Your Honor, apparently Mr. Travis, from his remarks before the Court, is not intending to challenge the validity of the regulation which provides that where there is a field or market price, that that field or market price shall control in determining the first com-

mercially marketable product of a pit or mine. His remarks, indicating the regulation is older than the particular provisions of the statute, brings out what has been recognized many times by the Supreme Court as a factor of interpretation; that is, where a regulation has stayed in effect while the statute is modified and the regulation is not dealt with, that it at least indicates congressional intent not to tamper with the regulation or change its effect. Now, in dealing with this particular aspect of the case, the first problem: What is the first commercially marketable mineral product of this particular mine owner's mine or operator's [fol. 19] mine? I would like to refer directly to that regulation. Regulation 29.23 M-1(f)(3):

> "If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, gross income from the property means the amount for which such property was sold."

They have indicated here, and we would concede, that they have sold only a negligible part of their own particular production and do not come within the meaning of that section. But the regulation goes on to say:

> "If the product is transported or processed other than by ordinary treatment processes before sale, gross income from the property means the representative market or field price of a mineral product of like kind and grade."

That, your Honor, presents the problem which is before the Court . . .

The Court: (Interposing) I appreciate you are answering Mr. Travis. But in the opening statement do we need to get into a legal argument? Let's confine it to an opening statement, and we will have final argument.

Mr. Friesen: (For Deft.) Basically, the Government intends to prove not only is there a market for crude clay of a like kind and grade to what the taxpayer produces, but what the taxpayer produces does not come within the commonly understood meaning of the term "fire clay."

This conclusion as to fire clay is based upon the proposition that the taxpayer presented to the Government in its argument before the Appellate Staff. It presented chemical

analyses of a pyrometric cone equivalent of 17, and the great weight of the evidence, and the literature on the sub-
[fol. 20] ject, indicates that the low-duty fire brick loses its refractory use there. It needs a Cone 19 equivalent.

The American Society for Testing Materials, a well recognized authority on the subject, printed this Standard in several different places in its most recent publications.

The one problem which appears most apparent is that taxpayer asserts there is no market for the product of its mine which is representative of the market in the Cannelton Area. Of course, any market presents economic factors and problems of proof. To prove a market means we would apparently have to bring in every person who ever purchased or ever sold to show what the market is for. We have tried to select representative sellers and purchasers to bring before Court to indicate what the market is and where it is.

Mr. Travis indicates he will prove it would be uneconomical to transport clay from Brazil, Indiana, where clay is sold daily in large-ton lots, to the Cannelton Area. The economics of the situation will also be a matter of proof and the Government will offer evidence to show the average cost, including a profit, of transporting clay is 1.8 cents per ton mile. The Government will further demonstrate at that price, comparing with the price that was paid by the taxpayer to haul clay, they could haul clay considerable distances.

We can also show, I believe, and Mr. Travis is not unaware of the proof we intend to offer, since we offered it by deposition taken in his presence, that there were actual sales of large volumes of clay in the Cannelton Area, and, in fact, this taxpayer now purchases all its supply of clay from a distance of eight miles away. And in the Year 1951, the year in suit, the Owensboro Sewer Pipe Company, making a competitive product, hauled clay taken from a pit near
[fol. 21] where they now get their clay, some 30 miles from Owensboro, to manufacture sewer pipe. And in 1951 they had what is a purchase agreement. Now, not intending to get into a legal argument, I can understand and anticipate the answer which counsel will make to this particular proposition. L. R. Chapman was the deponent, and he testified that he owned some 3,000 acres of land on the Kentucky side of the Ohio River, just south of Cannelton, and that he made

arrangements with these ceramic producers to sell them clay, and the arrangement was always couched in terms of a contract for mining and delivery. Mr. Chapman would sell or transfer by lease for a nominal consideration, anywhere from One to Fifty Dollars, the title or lease-hold on the property, and at the same time, and as a condition of transferring that land, would take a contract to mine and deliver clay. He would not transfer the land without having this right to mine and deliver. He was in fact, and is now in fact, mining and delivering clay to the taxpayer for the purpose indicated. The Government shall contend that this constitutes a market.

We are not asserting here or raising any issue of who has the economic interest in the particular lease-hold or basic land. That is a problem involved in depletion, but fortunately, we don't have it here. We are not involved in that legal problem. But the fact situation it forms, the substance of what the transaction which occurs there is the people need clay, they go out and pay a price for it, and they get that clay delivered to their plants for that price. In 1951 there is strong evidence of this "purchase," we typify it, of clay materials satisfactory for use in their plant within eight miles of Cannelton, Indiana. And with these two propositions, we will rest our case.

The Court: Call your first witness.

[fol. 22] The Plaintiff, to maintain the issues in its behalf, offered and introduced the following evidence, to-wit:

Mr. Travis: (For Pltf.) Your Honor, may I have Stipulation No. 1, which I believe should be in the file?

(Court tenders stipulation to Counsel.)

Mr. Travis: (For Pltf.) Does the Court wish to have this identified?

The Court: I believe I would.

(The plaintiff, for purposes of identification, handed the reporter a certain document for marking and which was by said reporter marked Plaintiff's Exhibit No. 13.)

Mr. Travis: (For Pltf.) Plaintiff now offers in evidence, Plaintiff's Exhibit 13, a stipulation by the parties.

(Plaintiff's Exhibit No. 13 was offered in evidence by Mr. Travis at this time.)

The Court: Any objection?

Mr. Friesen: (For Deft.) No, your Honor.

The Court: Is that your stipulation?

Mr. Friesen: (For Deft.) That is the stipulation of facts which we have executed and is filed with the Court.

The Court: Exhibit 13 is admitted, read, and exhibited in evidence.

(Plaintiff's Exhibit No. 13 is admitted and read into the evidence, and made a part of the record in this case, said exhibit being in the words and figures following, to-wit:)

(Here Insert.)

[fol. 23] Eugene C. Clemens, a witness called on behalf of the plaintiff, being first duly sworn, testified as follows:

Direct examination.

Questions By Mr. Travis:

1 Q. State your name and where you reside, please.

A. I am Eugene C. Clemens. I live at Cannelton, Indiana.

2 Q. What is your occupation, Mr. Clemens?

A. I am Vice-President of the Cannelton Sewer Pipe Company.

3 Q. Do you hold an office with any other companies or corporations?

A. Yes. I am Vice-President of the Texas Vitrified Pipe Company, Mineral Wells, Texas.

4 Q. What duties do you perform with Cannelton Sewer Pipe Company as Vice-President?

A. In general administrative, production, and technical duties.

5 Q. What specifically do you deal with in those duties?

A. You mean in production?

6 Q. Yes, — research, whatever you—What I want to know: What do you do in relation to the clay you use in that plant?

A. I am in charge of the production methods, and also in charge of all technical work of that company.

7 Q. Do you have any college degrees, Mr. Clemens?

A. Yes. I have a Bachelor of Science in Ceramics from the University of Illinois, and Master of Science in Ceramic Engineering from the same school.

8 Q. Are you a professional engineer, registered professional engineer in any state?

[fol. 24] A. I am a registered professional engineer in the States of Indiana and Texas.

9 Q. What societies do you belong to that deal with ceramics?

A. I am a Trustee of the American Ceramic Society, a national ceramic organization; I am a member of the American Society of Testing Materials; I am a Trustee of the National Clay Pipe Research Corporation; I am a member of the Advisory Committee of the National Clay Pipe Manufacturers, Inc.'s Research Committee.

10 Q. How long have you been connected with the Cannelton Sewer Pipe Company?

A. For about thirty years.

11 Q. During that time have you been in charge of all of their research as to clay and the use thereof in their business?

A. I have.

12 Q. What does the Cannelton Sewer Pipe Company make for sale?

A. We make, the Cannelton Sewer Pipe Company makes vitrified clay sewer pipe, vitrified wall coping, flue lining, and filter block.

13 Q. Are you familiar with the clay pits or mines and the plants which use clay in their manufacturing in Southern Indiana and Northern Kentucky?

A. I am familiar with all of the plants in those areas.

14 Q. Have you in your work, particularly on sewer pipe, traveled extensively throughout the country and visited other plants?

A. I have visited practically every sewer pipe plant in the United States.

15 Q. How many sewer pipe producers are there in the State of Indiana?

A. There are four.

16 Q. In the plaintiff's Complaint, Mr. Clemens, at [fol. 25] paragraph 20, there are set out various processes which apply by Cannelton Sewer Pipe Company to the clay

which it mines in order to produce a finished vitrified product. Are those processes the ones that customarily and normally are used by the other producers of vitrified sewer pipe throughout the United States?

A. Yes.

17 Q. Reducing those processes greatly, would you tell the Court in simple language what you do to that clay in order to, after it is mined, in order to produce a vitrified sewer pipe?

A. It is transported from the mine to the plant, where it is pulverized, and prepared to the proper grain size, mixed with water to the proper consistency, extruded into the form of clay products, dried, and fired by our special firing process.

18 Q. Now, in the grinding, that clay gets about as fine as talcum powder, doesn't it?

A. Correct.

19 Q. And when you mix it with water, you get a very thick mud out of it. Isn't that the way it is?

A. What we describe as a plastic mass.

20 Q. And when you extrude it, as you call it, you form it into the shape of a piece of sewer pipe?

A. Formed into the shape of the finished product.

21 Q. And that is done on automatic presses or machines?

A. Automatic and semi-automatic.

22 Q. And when you speak of drying, your first drying process, that is before it goes in a kiln, is that so?

A. Yes.

23 Q. And how is that process accomplished?

A. That drying process is accomplished by carefully regulating the heat to the ware, after it has been placed in dryers where we can control the heat, and the [fol. 26] humidity, by processes we have learned in production to obtain a product which is free from defects and can be properly fired.

24 Q. What does that drying do to the extruded piece of pipe?

A. It essentially removes all the water we add in the process of previous manufacturing process.

25 Q. It does not remove any other mineral or substance whatsoever except the water you have added?

A. It makes no other change.

26 Q. Now, you speak of firing this piece of pipe. What do you do when you fire it?

A. After the ware is placed in the kilns, it is subjected to heat treatment within those kilns in order to properly control the shrinkage and to bring the ware to the stage of vitrification, or the hardened state, where it will be a finished product.

27 Q. Why do you have to dry the pipe at a reasonably low temperature before you put it in the kiln?

A. Because if we dry it at a temperature higher than 212 degrees, we would form steam within the kiln and destroy it.

28 Q. Are there any dangers connected with the drying process? Could I do it in the kitchen if I threw heat on this wet mass?

A. I don't think you could do it with any degree of skill.

29 Q. What might happen to it, if I didn't do it right?

A. You would ruin the ware.

30 Q. In what respect?

A. Probably blowing it up, breaking it.

31 Q. It would crack?

A. It would crack, yes.

[fol. 27] 32 Q. And the heat inside the kiln you raise by graduat control process?

A. Yes.

33 Q. Temperature?

A. Yes.

34 Q. What is the maximum temperature that you reach in the kiln for vitrification?

A. For the clay in question that was 2200 degrees Fahrenheit.

35 Q. When you say "that" you are referring to clay used in 1951?

A. 2200 degrees Fahrenheit.

36 Q. How long does the drying process you have described take?

A. The drying process depends on the size of the ware, and it will take anywhere from 12 hours to three weeks; the larger the ware, the longer the drying time.

37 Q. And how long a time is the ware in the kiln?

A. The ware in the kiln requires from 60 to 210 hours,

depending on the size, for the firing process, after which the ware must be heat treated by careful cooling.

38 Q. And after you are through firing it in the kiln, when the kiln is cooled off, you haul it out and load it and store it?

A. It is graded and either hauled to shipping conveyances, or put in storage.

39 Q. What materials was your company mining in 1951?

A. We were mining a fire clay and a shale.

40 Q. Where was the mine in relation to your plant?

A. The mine was about 1.4 miles from the plant on Indiana State Highway 237.

41 Q. Was that an open pit or underground mine?

A. It was an underground mine.

[fol. 28] 42 Q. How long prior to '51 had that mine been used by your company?

A. That mine was opened in 1937.

43 Q. What do you mean by "shale"?

A. Shale is a form of clay which is thinly laminated or stratified.

44 Q. You say shale is a form of clay?

A. Yes.

45 Q. What do you mean by "fire clay"?

A. Fire clay is an aggregate of minerals which is irregularly deposited. By that I mean it is not stratified or consolidated into the form of layers as compared with shale.

46 Q. It, too, is a clay; is that right?

A. It is a clay, yes.

47 Q. What is clay?

A. Clay is an aggregate of minerals, and those minerals are hydrous silicates of alumina.

Mr. Travis: (For Pltf.) Your Honor, I am not going to introduce these in evidence, but I want him to show the Court what these products are. (Counsel referring to a sample of shale and a sample of fire clay).

48 Q. (By Mr. Travis) What is the piece of rock I am handing you?

A. This material is a shale.

49 Q. And how do you tell that?

A. By its laminae or its character where it is laid down in thin sheets.

50 Q. And what is this material?

A. This is a fire clay.

51 Q. How do you distinguish it from that?

A. By its irregular method of laying down, by the evidence of roots that were grown into it at the time it was deposited, which indicates that it was laid down under a coal.

[fol. 29] 52 Q. Are these two samples which I just handed to you actual samples from the mine from which you were extracting clays in 1951?

A. Yes.

53 Q. How did those materials in 1951 lie in their natural deposits?

A. As I told you before, we mine underground. There was a thin layer of coal. Directly underneath that thin layer of coal is about six feet of fire clay. Directly below that was the shale.

54 Q. How thick was the shale bed?

A. That was probably two to four feet. It varied slightly.

55 Q. And in your mining out of that mine in 1951, did you remove and use both of those strata or veins of fire clay and shale?

A. Yes, we mined them together.

56 Q. So that the materials which you have used in making your products contain both fire clay and shale in about the proportions of six feet to an average of three feet. Is that true?

A. The average proportion was about 60 per cent fire clay and 40 per cent shale.

57 Q. You were present at the taking of the deposition of Dr. Haydn Murray on last Saturday, were you not?

A. Yes.

58 Q. And you heard him testify as to the properties and location of fire clays in the State of Indiana?

A. Yes.

59 Q. Do you agree or disagree with any of the statements which he made in that regard?

A. I agree with his statements.

60 Q. What do you call this strip of fire clay that runs through Southern Indiana?

[fol. 30] A. The fire clay through Southern Indiana that

we are using, and the only strip of fire clay in Southern Indiana, is described geologically as the Pennsylvania Clays.

61 Q. And what do you mean by the Mansfield formation?

A. That is a division or grouping within the Pennsylvanian age.

62 Q. Was your mine in 1951 in what is called the Mansfield formation?

A. Yes.

63 Q. Does a piece of vitrified sewer pipe have to be made from fire clay or part fire clay?

A. It depends entirely on the nature of the materials that you have. It is possible to make sewer pipe without fire clay, but it is much better to use fire clay.

64 Q. In this particular area, where your sales of finished products are made, in order to be competitive on the quality basis, would it be necessary for you to use fire clay or partly fire clay?

A. Yes.

65 Q. Why?

A. Because it is needed to control the manufacturing and the firing processes.

66 Q. The clays which are used for the production of your finished sewer pipe, must they have any, what is called plasticity?

A. Yes.

67 Q. Why?

A. If they were not plastic, it would not be possible to form them with the processes and the machinery which we have.

68 Q. What do you mean by "plasticity"?

A. Plasticity is the property of becoming sticky or workable when wet with water.

69 Q. For example, just before your clay goes into [fol. 31] the extrusion process, could you form it with your hands and fingers?

A. You could form it into a shape, which piece would retain its shape after being formed. Is that what you mean?

70 Q. Yes. I mean it is soft.

A. It is soft and pliable.

71 Q. Now, must the clay which you use in producing sewer pipe have any particular characteristics regarding its drying qualities?

A. That is one of the most important characteristics in the manufacturing processes inasmuch as if you can not control the drying, you can not successfully make sewer pipe, and it is necessary to properly blend the clays and to properly process them in order to get successful drying, or to have successful drying.

72 Q. Don't all clays dry the same?

A. No, they do not.

73 Q. So that you have to use the clay that has particular drying qualities?

A. Yes.

74 Q. How about the firing of the pipe in the kiln? Does that require any special qualities in the clay?

A. Very special qualities inasmuch as the mineral characteristics of the clay and its ability to withstand high temperatures must be known and carefully controlled.

75 Q. And here, again, can any piece of clay be fired?

A. No, it can not. It can be fired, but not successfully.

76 Q. Can it be vitrified?

A. Not successfully, not any clay. It requires special characteristics.

77 Q. You call your product a vitrified clay sewer pipe. What do you mean by "Vitrified"? What is "Vitrified"? [fol. 32] A. Means it is fired to a very hard or glazy state.

78 Q. And here, again, do different clays have different qualities as to vitrification?

A. Very much so; depends entirely upon the natural characteristics of any particular clay.

79 Q. Supposing you were exhausting a clay pit at the present time, what would you have to do find another suitable mineral to use in making vitrified sewer pipe?

A. We would have to do considerable prospecting, first, to find enough material to use, and second, we would have to do considerable laboratory pilot plant and production testing in order to prove any deposits which we might locate.

80 Q. How do you do that?

A. In prospecting we usually engage the services of a

geologist to locate a definite to advise us on the geology of the area and to make initial locations. We then either or drill or excavate into the deposits in order to determine their extent and if, after the extent has been determined, it is necessary to carry the samples into our laboratory or a recognized ceramic laboratory and have ceramic tests of all types made to determine the suitability of that material to manufacturing purposes, for manufacturing purposes.

81 Q. It has been stated in the opening statements that your company is now obtaining its supply of clay and shale from Hancock County, Kentucky. Is that true?

A. Yes.

82 Q. To what extent did you, and whomever you had employed with you, prospect and carry on research in Hancock County, Kentucky, before you found a suitable clay?

A. We investigated the deposits of Hancock County, prospected and tested them for a period of about five years.

[fol. 33] 83 Q. When did you start getting material from Kentucky?

A. I think it was in January or February of 1947; I am not sure of the exact date.

84 Q. It was just last year?

A. Last year.

85 Q. Is there still clay and shale deposits left in the mine that you were using adjacent to Cannelton?

A. There are some, yes.

86 Q. It was not because you ran out of clay, then, that you switched to Kentucky?

A. No.

87 Q. What do you mean by pyrometric cone equivalent?

A. Pyrometric cone equivalent is a ceramic test used to measure the fusion point of a clay.

88 Q. Would you tell the Court briefly what you do when you make this test?

A. You make this test, small cones about like a small wedge, probably an inch and one-half long, are made from the clay in question, clay to be tested, and these are fired with cones which have been prepared by a recognized laboratory, which have definite melting points, so that the clay in question, when it fuses, can be compared with the fusion point of a known material or a known cone.

89 Q. And at a certain P.C.E.?

A. P.C.E. is the measure of the temperature and heat treatment of a particular clay.

90 Q. Have you, throughout the years of using the particular mine in question in 1951 and the one across the road from it which was opened later, had tests made of that clay?

A. Yes, we have.

91 Q. Both P.C.E. and chemical analyses?

[fol. 34] A. We have had P.C.E. and chemical analyses and ceramic tests made.

92 Q. What is the P.C.E. of the fire clay which you were mining in 1951?

A. Our average tests show it to be Cone 29.

93 Q. Some of those tests have been as low as 19?

A. Some have been as low as [illegible], and some as high as 26.

(The plaintiff, for purposes of identification, handed the reporter certain documents for marking, and which were by said reporter marked plaintiff's Exhibits No. 14 and No. 15.)

94 Q. (By Mr. Travis) I hand you what has been identified as Plaintiff's Exhibit 14, and ask you to state what that is.

A. This is a report of a test by The Bruce Williams Laboratories, of Joplin, Missouri, on a test made to determine the pyrometric cone equivalent of fire clay and shale which was taken from the Cannelton Sewer Pipe Company mine in 1953.

95 Q. Will you identify Exhibit 15, please?

A. Exhibit 15 is a chemical analysis by The Bruce Williams Laboratories in Joplin, Missouri, dated January 7, 1954, on the fire clay taken from the deposits of the Cannelton Sewer Pipe Company.

96 Q. Are those two reports the same in regard to the same samples of clay?

A. Yes.

97 Q. Then just tell the Court, please, what the pyrometric cone equivalent was of the two samples reported in Exhibit 15 . . .

The Court: (Interposing) Do you have any objection to the exhibit? He is starting to read the contents.

Mr. Travis: (For Pltf.) I will make the offer of the exhibits at this time.

[fol. 35] (Plaintiff's Exhibits No. 14 and No. 15 were offered in evidence at this time by Mr. Travis.)

Mr. Friesen: (For Deft.) I object to the admission of this Exhibit unles the witness can identify from his own personal knowledge that the samples were taken from the clay, rather than the shale, since there is a different percentage applied to the two.

Mr. Travis: (For Pltf.) He testified it was fire clay.

Mr. Friesen: (For Deft.) May I take him on voir dire, then?

Mr. Travis: (For Pltf.) Sure.

Mr. Friesen: (For Deft.) How do you know these were clay rather than shale?

The Witness: Because I saw the samples taken from the mine.

Mr. Friesen: (For Deft.) Did you take the sample?

The Witness: I did not. I saw them after they were taken. They were taken by our Superintendent.

Mr. Friesen. (For Deft.) And what method of sampling was used?

The Witness: In the case of the fire clay, it was a typical cross-section of the vein.

Mr. Friesen: (For Deft.) Now, you are referring to 665763?

The Witness: Yes.

Mr. Friesen: (For Deft.) And the other was a shale?

The Witness: Yes, 764 was the shale.

Mr. Friesen: (For Deft.) I have no objection.

The Court: All right, Exhibits . . .

Mr. Friesen: (Interposing for Deft.) Excuse me, your Honor. If it is determined by the Court that the materials taken in '53 and '54 are relevant to this case in showing quality—and I think that we may have this problem in a number of instances as to date since no one knew in 1951 [fol. 36] we were going to have a lawsuit on this case—I will have no objection; but if we are restricting our evidence entirely to the Year 1951, I make my objection to this on that ground.

The Court: What do you say about his objection?

Mr. Travis: (For Pltf.) I will clear that question up in this immediate regard.

The Court: Do you have some further questions?

Mr. Travis (For Pltf.) Yes.

98 Q. (By Mr. Travis) The mine from which you were extracting clay in 1951, was that abandoned by you, your company?

A. Yes.

99 Q. When?

A. I believe in 1952, in the Spring of 1952.

100 Q. And what did you do then?

A. We opened another entry into the same vein at a different location so as to reduce the amount of haulage to the face of the mine.

101 Q. As a matter of fact, the second mine that you opened was practically across the road from the other one.

A. Directly across the highway.

102 Q. And you say it was the same vein of clay?

A. Yes.

103 Q. And did it have the same general qualities and characteristics?

A. Yes.

Mr. Travis: (For Pltf.) With that, your Honor, I will renew my offer.

(Plaintiff's Exhibits No. 14 and No. 15 were reoffered in evidence at this time by Mr. Travis.)

Mr. Friesen: (For Deft.) You testified this was not from the same mine, I believe as you originally had in 1951.

[fol. 37] The Witness: That's right.

Mr. Friesen: (For Deft.) Does clay vary in quality both laterally and vertically?

The Witness: I don't understand what you mean by "quality."

Mr. Friesen: (For Deft.) Will a clay deposit vary in its constituent elements both laterally and vertically?

The Witness: Depends entirely upon the geological formation.

The Court: What about the same vein?

Mr. Friesen: (For Deft.) I believe the testimony will indicate Dr. Murray said it will definitely vary laterally

and vertically within a few feet of the same point. His testimony was, I believe, it would not vary significantly. I think this is relevant, showing we have like kinds and grades of clay in other deposits.

Mr. Travis: (For Pltf.) Your Honor, I think Mr. Friesen is definitely getting into cross-examination. The reason I know, I know how long it is going to take because I heard it last Saturday. It does not go to the admissibility of this particular exhibit.

The Court: Would you qualify your witness a little more. You used the term "across the road." How far was the second mine?

104 Q. (By Mr. Travis) How far was the entrance of the second mine from the entrance to the first?

A. I would say roughly about 2,000 feet.

The Court: How far had they mined back into the old mine?

105 Q. (By Mr. Travis) Yes. Do you know how far you were back in the old mine?

A. Probably a mile.

106 Q. And, of course, the new mine you just opened up directly at the mine opening and started mining how far back in?

[fol. 38] A. The new mine?

107 Q. Yes.

A. We were probably a mile in the new mine.

108 Q. When you started mining, how far did you have to go?

A. Probably have to go in 4500 feet before we get satisfactory material.

109 Q. And the products which you manufactured from the two mines, were they of like quality and kind?

A. Yes. We used the two clays concurrently, the two materials from the two mines concurrently.

Mr. Travis: (For Pltf.) I think, your Honor, that should be enough to qualify the exhibits.

The Court: The objection will be overruled, and Exhibits 14 and 15 are admitted and read in evidence.

(Plaintiff's Exhibits No. 14 and 15 are admitted and read into the evidence, and made a part of the record in this

case, said exhibits being in the words and figures following, to-wit:)

(Here Insert.)

110 Q. (By Mr. Travis) Will you tell the Court the pyrometric cone equivalent shown on Exhibit 14?

A. The pyrometric cone equivalent for the fire clay was Cone 19 to 20.

111. Q. Except for h test which was made on this clay from this same mine to which M Friesen referred in his opening statements, have you ever had a test made with a P.C.E. showing less than 19 on your fire clay?

A. No.

112 Q. Can you say it has been as high as 26?

A. Yes.

The Court: Has he made other tests?

[fol. 39] 113 Q. (By Mr. Travis) Have there been tests made through the years?

A. There have been tests made in our own laboratories and by the Geological Survey.

Mr. Travis: (For Plff.) Your Honor, the deposition which will be read later also shows the Indiana Geological Survey made tests of its own, independent. They are already attached as exhibits to the deposition.

114 Q. (By Mr. Travis) In 1951 did you use in your production of sewer pipe all of the clay and shale which you mined?

A. Yes.

115 Q. Did you sell any of that clay in other than the finished product?

A. Not to my knowledge.

116 Q. I mean of the ground fire clay.

A. There may have been an infinitesimal amount of ground clay.

117 Q. In the raw form, as the clay comes out of the ground, do you know did you sell?

A. We sold no crude raw clay.

118 Q. Have you up to date?

A. No.

119 Q. Did you buy any clay or shale of any kind in 1951?

A. No.

120 Q. Do you know all of the other producers of clay products in the area of Cannelton, Indiana?

A. Yes.

121 Q. In 1951 do you have any knowledge of any sales of raw clay to or by any such producers of clay products?

A. No.

[fol. 40] 122 Q. Do you know in the immediate Cannelton Area of any mine owner or operator who mined and sold clay to others?

A. No.

123 Q. Is there a market price for clay in Cannelton, Indiana?

A. No.

124 Q. What is the nearest sewer pipe producer in Cannelton?

A. You mean in any state?

125 Q. No; in Indiana.

A. The nearest producer in Indiana is the American Vitrified Products Company, Brazil, Clay County, Indiana.

126 Q. You stated there were four producers of sewer pipe in Indiana in 1951 other than your company. Are the other three located in the Brazil, Indiana, Area?

A. Two are in Brazil, Indiana, and one is in Mecca, Indiana.

127 Q. And that is north of Brazil?

A. North of Brazil.

128 Q. Mecca is in Parke County?

A. Yes.

129 Q. You heard Dr. Murray testify in his deposition that the clay in the mines which you have identified is called the Cannelton clay, have you not?

A. Yes.

130 Q. Is that because it lies under what is called the Cannelton coal?

A. Yes.

131 Q. What is the nearest producer of any vitrified clay product to Cannelton which was using Cannelton clay in 1951?

A. Can you state the question again?

[fol. 41] The Court: Read the question.

(The reporter read the last preceding question as follows: 131Q. "What is the nearest producer of any vitrified clay product to Cannelton which was using Cannelton clay in 1951?")

A. There was no one else using Cannelton clay in 1951.

132 Q. (By Mr. Travis) Is the clay which is now being used by your company and others from Hancock County, Kentucky, a so-called Cannelton clay?

A. No.

Mr. Travis: (For Pltf.) Your Honor, the Plaintiff's Exhibit 1 is a map which is attached to Dr. Murray's deposition, and I will refer to Exhibit 1 although this is not the one that was introduced. (To Mr. Friesen) Could I have one of those to let the Judge look at?

The Court: Gentlemen, suppose we take a few minutes' recess here.

(Whereupon the Court was recessed at 11:10 a.m., and reconvened at 11:35 a.m., at which time the following proceedings were had.)

Mr. Travis: (For Pltf.) Your Honor, the plaintiff would like to interrupt at this time, and have the deposition of Dr. Haydn H. Murray published, so I can get the exhibits out of it.

Mr. Friesen: (For Deft.) No objection, your Honor.

(At this time the deposition of Dr. Haydn H. Murray was published.)

133 Q. (By Mr. Travis) I was referring, Mr. Clemens, at the time of recess, to Plaintiff's Exhibit 1 attached to the deposition of Dr. Haydn Murray. Would you tell the Court in general what that is?

[fol. 42] A. This is a map showing the location of the clay and shale pits and the ceramic plants in Indiana.

134 Q. Referring to Perry County, where, in general, is that located?

A. Perry County is located in the extreme south central part of Indiana on the Ohio River.

135 Q. The south boundary is the river?

A. The Ohio River.

136 Q. I notice in Perry County there are shown, according to the explanatory marks, a black triangle which is the Pennsylvanian shale pit and ceramic plant, and a black circle which is a Pennsylvanian clay pit and ceramic plant. Do those two designations refer to the mine which the Cannelton Sewer Pipe Company was using?

A. Yes.

137 Q. Immediately to the north is what is stated as a "Pleistocene water-laid clay pit and ceramic plant." What plant is that?

A. That is a plant of the United States Brick Company.

138 Q. What material do they use in producing their product?

A. They use a river-bottom silt, or a, as described here, a water-laid clay.

139 Q. Would that clay be suitable for producing sewer pipe in your plant?

A. No.

140 Q. Now, working your way along the river westward, what is the next plant or pit shown on the map?

A. In Spencer County is a brick plant, Rockport Brick and Tile Company, which used the same type of water-laid material for producing brick.

141 Q. Is that what you would call "river silt"?

A. Yes.

[fol. 43] 142 Q. Would that be suitable for producing sewer pipe in your plant?

A. No.

143 Q. Now, getting clear over to Vanderburgh County, what is there over there in the way of clay production?

A. To my knowledge there were two plants in Vanderburgh County, owned by the Standard Brick and Tile Corporation; one used river silt to produce brick; the other used a shale to produce brick and tile.

144 Q. Would either of the materials used by those companies be suitable for the production of sewer pipe in your plant in 1951?

A. No.

145 Q. Now, going northward to DuBois County, would you state what the map shows as to mines or plants in that county?

A. In DuBois County is shown a symbol which says "Ceramic plant," which I presume referred to the Huntingburg Brick Company. There is also a symbol which shows the "Pennsylvanian clay pit" with which I am not too familiar. There is also another symbol which shows a "Pennsylvanian shale pit" with which I am not too familiar.

146 Q. Have you ever tested any of those, the material, in DuBois County?

A. Yes.

147 Q. Have you found any that were suitable for making sewer pipe in your plant?

A. Yes.

148 Q. Now, how far is Huntingburg from Cannelton?

A. About 24 miles.

149 Q. If you had been told in 1951 that you could purchase fire clay at Huntingburg for Three Dollars and a [fol. 44] Quarter a ton, loaded in your trucks, could you have transported that clay to your plant in Cannelton cheaper than you were mining clay in your own mine?

A. No.

150 Q. There will be evidence introduced, I am assuming, Mr. Clemens, that clay possibly suitable for the manufacture of sewer pipe was readily available in Clay County, Indiana, during 1951. Could your company have transported that clay from Brazil, Indiana, at any conceivable price, to your plant in Cannelton and had a cost at your plant less than your cost of mining from your own mine?

A. No.

151 Q. What would you say was the maximum hauling distance of raw clay to your plant for a profitable operation in the manufacturing of sewer pipe?

A. Assuming a reasonable price, a reasonable cost at the mine?

152 Q. Yes.

A. About 10 miles maximum.

153 Q. Is it generally, almost universally true, that plants which produce clay products are located in the very immediate vicinity of a mine with clay suitable for their manufacturing?

A. Yes.

154 Q. Is clay as such a relatively plentiful mineral?

A. I will have to qualify my answer to that by saying that there are many clays and shales, and of many different characteristics, and as such it is a relatively plentiful material, generally speaking, geologically speaking.

155 Q. Isn't it probably the most plentiful mineral on the face of the earth?

A. Clays, shales, and stone.

156 Q. What was the freight rate by railroad from Huntingburg to Cannelton for raw clay?

[fol. 45] A. May I refer to some notes for that?

157 Q. Yes, please do.

A. (Witness referring to notes) Before I came over here, I—You are talking about rail now?

158 Q. Yes.

A. Before I came over here, I checked with the Southern Railway, which is the only railroad coming into the Town of Cannelton, and they gave me a commodity rate on clay from Huntingburg to Cannelton of $2.82 per ton, plus 3 per cent Federal tax.

159 Q. And do you have the rate from Cannelton to Brazil?

A. I would like to qualify that—All right, I will give you that rate, and then I will have to qualify it by saying sometimes it is a different rate in different directions. Cannelton to Brazil, the rate quoted us, quoted the Cannelton Sewer Pipe Company by the Southern Railway was $4.45 per ton, plus 3 per cent.

160 Q. Federal tax

A. Federal tax, yes, sir.

161 Q. Does that same rate prevail if you were going the other way, from Brazil to Cannelton?

A. The information given to the Cannelton Sewer Pipe Company by Southern Railway was to the effect that that rate did not apply from Brazil to Cannelton; that it was necessary to use a class rate which was $8.60 per ton, plus 3 per cent Federal tax.

162 Q. If that clay was laid down at the railroad yard in Cannelton, what would you have to do to get it into your first stage of operation in your plant?

A. We would have to unload the clay and transport it either to clay storage or to the grinding plant for processing.

163 Q. What do you think that would cost you?

A. The mine cost would be $1.00 per ton.

164 Q. $1.00.

[fol. 46] A. And that is conservative.

165 Q. Do you know anything about the prices paid for clay in Clay County in 1951, where it was sold?

A. We did not attempt to get any prices from Clay County.

166 Q. You are not familiar with any price that was current there in 1951?

A. No, I am not.

167 Q. What do you think it would cost you to haul clay by your trucks from Huntingburg, delivered into your plant?

A. Before coming here we had our Shipping Department estimate costs; for trucking in rather large trucks from Huntingburg to Cannelton, the amount of $4.00 per ton.

Mr. Friesen: (For Deft.) Your Honor, I object to the question. We do not have the witness who prepared the figures, and he has not qualified himself as an expert on computing such costs.

The Court: What do you say about that?

Mr. Travis: (For Pltf.) Let me qualify that a little.

The Court: Do you agree the answer goes out?

Mr. Travis: (For Pltf.) At this time I will.

The Court: All right.

168 Q. (By Mr. Travis) Were the records from which you are about to testify made from the regular business records kept by your company?

A. Yes.

169 Q. And will the costs about which you are about to testify, be related to directly to actual cost figures which your company has in its business records?

A. Yes.

Mr. Friesen: (For Deft.) I renew my objection that he is not testifying that he made any computation or examined the records. He is saying he had somebody [fol. 47] else do it. This is not the witness who has prepared the data he wants to testify from. I gather he has

in his hand some notes which he has made subsequent to that time.

The Court: I would sustain the objection. It would be pretty hard for these folks to cross-examine this witness on the basic factors. You can pass it for the time being and bring it up later on.

170 Q. (By Mr. Travis) In the years in which you have been an officer of the Cannelton Sewer Pipe Company, do you of your own knowledge have any knowledge of cost of hauling clay per ton mile?

A. Yes.

The Court: By truck, now?

171 Q. (By Mr. Travis) By truck?

A. Yes.

172 Q. What is that cost which is within your own knowledge?

Mr. Friesen: (For Deft.) As of what date, Mr. Travis?

173 Q. (By Mr. Travis) As of 1951, if you can remember.

A. I can't remember that year. I would prefer to refresh my memory from the figures.

174 Q. Have you taken from your regular business books of record some figures showing the cost of mining clay in 1951?

A. Yes.

175 Q. Would you please refresh yourself with them?

A. (Witness referring to notes).

176 Q. What was the cost per ton of mining clay and shale in your own mine at the mine of the Cannelton Sewer Pipe Company in 1951?

A. The cost was $2.418 per ton.

[fol. 48] 177 Q. Does that include transportation to your plant from the mine?

A. Yes.

178 Q. So, that was the cost laid down in your plant?

A. Yes, that was the cost dumped into our grinding plant.

179 Q. Were you familiar with the producers of clay products in Hancock County, Kentucky, in 1951?

A. I don't think there were any producers in Hancock County in 1951.

180 Q. Are you familiar with any mining, clay mining, operations in that county in 1951?

A. Yes.

181 Q. Where is Hancock County, Kentucky?

A. Hancock County, Kentucky, is directly—It is in Kentucky, directly across the Ohio River, south of Perry County.

182 Q. Indiana?

A. Indiana.

The Court: Right across the river from your mine that you had in '51?

The Witness: Yes, sir.

The Court: The river is about a mile across there?

The Witness: About three quarters of a mile.

183 Q. (By Mr. Travis) What transportation is there across the river from Indiana to Kentucky?

A. Ferry.

184 Q. What is the town or city immediately opposite?

A. Hawesville.

185 Q. It has been testified, Mr. Clemens, in the deposition of, L. R. Chapman of Lewisport, Kentucky, which will be introduced lated in this proceeding, that in 1951 the only company in Kentucky for whom he was mining and hauling clay was the Owensboro Sewer [fol. 49] Pipe Company. Did you hear that deposition, that testimony?

A. Yes, sir.

186 Q. What other producers of clay products were getting their clay from Hancock County, Kentucky, in 1951?

A. To my knowledge none.

The Court: How far is Owensboro from this Hancock County? What is the distance from Owensboro to Hancock County?

The Witness: From Hawesville, the county seat, to Owensboro is approximately 30 miles by highway.

187 Q. (By Mr. Travis) Now, isn't there a company in that vicinity called Murray Brick and Tile Company?

A. Murray Tile Company is the correct designation; at Cloverport, Breckinridge County, Kentucky.

188 Q. Where did they mine any clay in 1951?

A. To my knowledge it was mined on their own property.

189 Q. Was that near or adjacent to their plant?

A. Immediately adjacent to the plant.

190 Q. Now, is there an Owensboro Brick Company?

A. Yes.

191 Q. Where are they located?

A. They are located in Owensboro, Kentucky.

192 Q. In 1951 do you have any knowledge where they were obtaining their clay supply?

A. To the best of my knowledge it was obtained from their own pit directly adjacent to the plant.

193 Q. And is there a Rockport Brick Company?

A. Yes.

194 Q. Where is that?

A. It is located at Rockport, Spencer County, Indiana.

[fol. 50] 195 Q. And where were they getting their clay, if you know, during 1951?

A. To the best of my knowledge they were taking it from a pit, an open pit immediately adjacent to their plant.

196 Q. And where is the Boonville Brick Company?

A. The Boonville Brick Company is at Boonville, Indiana. I do not know the—remember the name of the county. It's Warrick County.

197 Q. Do you know where they were obtaining their supplying of clay in 1951?

A. I am not too familiar with that plant, but to the best of my knowledge they were obtaining it the last time I was on the plant, at that time they were obtaining it from a pit near their plant.

198 Q. You have been in all of these plants you have testified about?

A. Yes.

199 Q. And have you been in their clay pits or seen them?

A. Yes.

200 Q. Are any of those companies, which you have mentioned other than the Owensboro Sewer Pipe Company, were they in 1951 producing any products similar to vitrified sewer pipe which you manufactured?

A. No.

201 Q. Would any of those companies require the same quality and characteristics in the clay which they use as that used by the Cannelton Sewer Pipe Company?

A. The qualities for their products are different, the manufacturing qualities are different than for clay sewer pipe.

202 Q. Have you ever been shown any tests of the materials used by any of those companies, or any other [fol. 51] companies in the vicinity of Cannelton, Indiana, as to the P.C.E. and chemical qualities of those clays?

A. Only the Owensboro Sewer Pipe Company.

203 Q. I will hand you what has been identified as Plaintiff's Exhibits 11 and 12, although they are identified in Dr. Haydn Murray's deposition. Will you tell the Court what they are, please?

A. These are fired test samples of fire clay which was taken from the mine of the Cannelton Sewer Pipe Company by Dr. Haydn Murray, formerly with the Indiana Geological Survey.

(The plaintiff, for purposes of identification, handed the reporter certain objects for marking, and which were by said reporter marked Plaintiff's Exhibit No. 16 and No. 17.)

204 Q. (By Mr. Travis) I hand you now what has been identified as Plaintiff's Exhibits 16 and 17, and ask you what those are.

A. These are fired test samples of shale taken from the mine of the Cannelton Sewer Pipe Company by Dr. Haydn Murray, formerly with the Indiana Geological Survey.

205 Q. And those are the same tests as are referred to in Dr. Murray's deposition as "shale"?

A. Yes.

206 Q. I call your attention to the difference in color of the samples. Is that a characteristic of shale and clay?

A. Usually a shale contains some iron which when fired causes it to have a darker color, darker color than fire clay.

207 Q. Referring again to the mine from which your company is now receiving its supply of clay and [fol. 52] shale in Kentucky, was that mine accessible to you in 1951?

A. No.

208 Q. Why not?

A. Well, I will have to qualify that. It was accessible, but not by a direct route.

209 Q. How far would that mine have been from your plant in 1951 by then existing highways suitable for truck transportation?

A. Slightly over 17 miles.

210 Q. How far is it now?

A. Approximately seven miles.

211 Q. And what had to be done to make that accessible at a distance of seven miles?

A. A new State and County Road was built through the area where we are now receiving clay.

212 Q. Was that road built at the special instigation of L. R. Chapman so the mine would be accessible?

A. A portion of the road was built for that purpose, yes.

213 Q. Prior to the building of that road, would it have been economically feasible for your company to obtain clay or shale suitable for the production of vitrified sewer pipe from the mine which you are now obtaining it?

A. No; the trucking costs would have been too high.

214 Q. Was What does it cost to take a truck across that ferry?

A. Those figures I am not exactly sure of. It is We have a rate with them.

215 Q. What is the rate?

A. I am not sure. I would have to look at the exact figures. I should have brought those along. I have them in my regular cost figures, but I hesitate to say offhand.

[fol. 33] The Court: How much longer would you be with the witness on direct examination?

Mr. Travis: (For Plff.) That's all, your Honor.

The Court: I think we have reached a good point for recess for lunch. We will recess until two o'clock.

(Whereupon the Court was recessed at 12:10 o'clock p.m., to reconvene at 2:00 o'clock p.m. this date.)

Indianapolis, Indiana, March 11, 1958. 2:07 o'clock p.m.

(The Court met pursuant to adjournment, and the trial was resumed as follows:)

Mr. Travis: (For Plff.) I have two questions, your Honor.

EUGENE C. CLEMENS, a witness called by the plaintiff, resumed the stand and testified further as follows:

Direct examination continuing.

Questions By Mr. Travis:

216 Q. Mr. Clemens, do you wish to correct the statement you made this morning regarding the distance, truck route distance, from Huntingburg to Cannelton?

A. Yes.

217 Q. And have you informed yourself during the noon hour of the exact mileage?

A. Yes.

218 Q. What is it?

A. The statement which I made this morning was based on the distance that I travel on country roads when I go to Huntingburg. The most direct route over which trucks [fol. 54] can travel from Cannelton to Huntingburg is 42 miles, which is the distance I took off the Indiana Highway Map.

219 Q. That is the map published by the Highway Commission?

A. Indiana Highway Commission.

220 Q. What is the distance, most direct truck route distance, from Brazil to Cannelton?

A. 140 miles.

Mr. Travis: (For Pltf.): Thank you. That's all.

The Court: Cross-examine.

Cross-examination.

Questions By Mr. Friesen:

221 Q. Mr. Clemens, you have spent a great deal of time explaining what the ordinary treatment processes were of the sewer pipe manufacturers. Are these the same ordinary treatment processes as are used by all clay mine owners and operators?

A. They are essentially the same processes used by manufacturers.

222 Q. Of sewer pipe manufacturers?

A. Yes.

223 Q. Aren't there a lot of clay mine owners and operators that don't manufacture sewer pipe?

A. Clay miners.

224 Q. Mine owners and operators who do not manufacture sewer pipe.

A. There are some.

225 Q. Do you have any idea what percentage of the total clay consumed is used in making sewer pipe, as opposed to brick and tile, or structural tile, or many of the other products that are made out of clay?

A. I couldn't speak with authority on that.

226 Q. Do you use the same treatment processes as the Huntingburg Brick Company?

[fol. 55] A. Partially.

227 Q. At what point don't you use any of the treatment processes any further?

A. The grinding process is different, the drying process is different, the firing and heat-treating process is different.

228 Q. So, up to the point where you begin grinding the material, your processes are the same, is that correct?

A. Crushing, it has to be crushed if it is delivered in lump form.

229 Q. And this would be true of any other manufacturer of ceramic products who didn't make sewer pipe, wouldn't it?

A. I can't say that that would be true, because there are many manufacturers of materials other than sewer pipe who get their clay in different forms, but whom I would not be entirely conversant.

230 Q. But the ordinary treatment processes of all mine owners and operators would include essentially the same mining and transporting operation to the grinding mill, isn't that correct?

A. You are referring to structural clay products, sewer pipe, or what?

231. Q. Any clay products. They all have to get the clay out of the ground and transport it to the place where they grind it?

A. Yes.

232 Q. But beyond that, the processes begin to differ, isn't that correct?

A. Yes.

233. Q. What is the market area for the products which you produce?

A. The finished product?

234 Q. Yes, Mr. Clemens.

[fol. 56] A. Indiana; Illinois; Kentucky; Tennessee, a portion of Tennessee; a portion of Missouri; a small portion of Arkansas. That is it.

235 Q. Any Ohio sales? Cincinnati, for instance?

A. No.

236 Q. Do you ever ship goods as far as Chicago?

A. Yes.

237. Q. Are there any vitrified sewer pipe manufacturers between Cannelton and Chicago?

A. Yes.

238 Q. What are those?

A. American Vitrified Products Company, Natco Corporation, and Clay City Pipe Company.

239 Q. And they all produce a product similar to yours?

A. A product that meets the same specifications for performance.

240 Q. Would--You would call them competitive with you, wouldn't you?

A. Yes.

241 Q. Now, how much does the cost of transporting clay differ from the cost of transporting finished sewer pipe?

A. We don't transport clay that distance, our company does not; so I could not compare the cost of transporting clay any great distance.

242 Q. What is the ton-mile cost of transporting your product to—over any distance?

A. I would have to refer to the company records for that.

243 Q. Now, when you testified this morning, when you knew the ton-mile cost of transporting clay over a relatively long distance, were you testifying with reference to the cost of transporting the finished product over those distances?

[fol. 57] Mr. Travis: (For Pltf.) Just a minute. To which the plaintiff objects. I believe I am correct in remembering that the testimony as to ton-mile cost of transportation, other than railway, was excluded on your objection.

Mr. Friesen: (For Deft.) I am trying to find out the source of his information.

Mr. Travis: (For Pltf.) Your question stated he testified

to the ton-mile cost, and I believe your objection was sustained to my question asking him that.

Mr. Friesen: (For Deft.) I am asking what the source of the figure was.

The Court: I have forgotten what the question is. Let's read the question.

(The reporter read the last preceding question as follows:

243 Q. "Now, when you testified this morning, when you knew the ton-mile cost of transporting clay over a relatively long distance, were you testifying with reference to the cost of transporting the finished product over those distances?")

The Court: As I recall, there was an attempt made to get that evidence in this morning which was unsuccessful; first objected to, and, then, they sought to qualify their witness by personal knowledge rather than the records built up by some employee of the witness.

Mr. Friesen: (For Deft.) Your Honor, I was trying to find out myself whether this witness knows what I am trying to find out.

The Court: When he got into his personal knowledge of it, his memory failed him then.

Mr. Friesen: (For Deft.) All right, I withdraw the question, then.

The Court: All right.

[fol. 58] 244 Q. (By Mr. Friesen) Mr. Clemens, do you know whether it is more difficult to transport your finished product than it is to transport raw clay?

A. I would say it was.

245 Q. Do you know whether it is more costly or less costly, speaking only in relative terms, to transport the finished product than the unfinished product, the raw clay?

A. That depends entirely upon who transports it.

246 Q. And when you testified that the manufacturers of brick require different qualities in the clay than you require for making sewer pipe, what are the different qualities that are required?

A. The clay required for making sewer pipe has to have a higher tensile strength than—a higher fired tensile strength than that required for making brick.

247 Q. Is there anything about the higher fired tensile strength that would prevent the material being used for making brick?

A. No.

248 Q. Then there is nothing about the quality of the material used in making sewer pipe that would prevent its being used for making brick, is there?

A. That depends upon what type of brick you want to make.

249 Q. What types of brick can not be made from sewer-pipe quality clay?

Mr. Travis: (For Pltf.) Your Honor, the plaintiff objects to the question for the reason that I, at least, can not see the materiality of this comparison between brick and sewer pipe, where we are concerned here solely with the production of sewer pipe by this plaintiff.

Mr. Friesen: (For Deft.) The plaintiff opened the inquiry by asking if there were different qualities involved. I am trying to find out whether the clay that is used at [fol. 59] Cannelton is not perfectly suitable at Boonville, or used by Murray Tile Company, all the companies he mentioned were making brick.

The Court: I am trying to get to the materiality. I picked you up on that. But the object of that testimony was to show what actual type of clay was used, and the testimony there was it was water silt.

Mr. Friesen: (For Deft.) Your Honor, I don't believe that is true as to Boonville.

The Court: That was his testimony, as I recall.—No; it was a shale.

Mr. Travis: (For Pltf.) All of them, he testified he had had no samples of the clay in 1951, and unless Mr. Friesen can supply him with analyses, I don't see how he can compare anything. Also, if he wants to ask about Boonville, why doesn't he ask about it, the specific question, rather than generalizing about the clay used for brick and sewer pipe?

The Court: If I can interrupt, that Boonville one was shale and shale only, and was not clay. Is that your memory of it?

Mr. Friesen: (For Deft.) I don't recall. Boonville has not always used shale.

The Court: That was his testimony from the map, and that is what you are cross-examining on. Exhibit 1 shows shale.

Mr. Friesen: (For Deft.) Of course, these taxpayers have a shale also, which is involved in this case. If we go further than that into these many producers who are in the area, for instance, Huntingburg Brick Company, it seems to me the witness was trying to imply there was a difference in the clay by virtue that the quality was not necessarily the same, and I am simply trying to extract from the witness an admission there is nothing about the clay in Huntingburg, or the underclays mined anywhere in Southern [fol. 60] Indiana, that are substantially different from the clays we have here.

The Court: What about shale differing from the clay? You asked him a question here; I think that was the question about Boonville. He hadn't testify it was a clay; he testified it was a shale.

Mr. Friesen: (For Deft.) Perhaps I picked the wrong one.

The Court: Let's read the question to be sure where we are. I understand shale is a clay but it is a different quality than the other type of non-shale clay.

Mr. Travis: (For Pltf.) I would like to point out, too, I think we should all keep it in mind that shale in this proceedings, there is no question about its depletion rate; that is fixed by statute. Therefore, Mr. Friesen questioning as to shale would not be pertinent because the marketability of shale is the only issue he has preserved. He certainly won't contest shale is entitled to 5 per cent depletion rate.

Mr. Friesen: (For Deft.) I certainly do not contest that, Mr. Travis.

The Court: Let's read the question.

(The reporter read the last preceding question as follows: 249 Q "What types of brick can not be made from sewer-pipe quality clay?")

The Court: What do you say about that, now?

Mr. Friesen: (For Deft.) I am asking that question to find if his original statement, regarding the differences in quality, refers to anything within the area of this suit.

Mr. Travis: (For Pltf.) I want to call the Court's attention to the fact that the question is absolutely in reverse

of the witness's testimony, as I recall it, this morning. He said that all clays will not make sewer pipe. Mr. Friesen's [fol. 61] question is what clays that will make sewer pipe won't make brick.

The Court: I will overrule the objection, and let's see where he is going from here. You may answer.

A. The use of any clay or shale by a manufacturer depends on his ability to make use of it, and I can not unreservedly say that you can make brick out of any sewer pipe clay.

250 Q. (By Mr. Friesen) But do you know of a sewer-pipe clay that can't be used for making brick?

A. I would say that the shale that is being used at Cannelton would be difficult, very difficult material to manufacture into brick, and shale that was being used in 1951.

251 Q. How about the clay that was being used in 1951?

A. That would be processed into brick.

252 Q. Do you know if it would make a high buff brick?

A. Yes.

253 Q. Turning to the transportation costs which you have discussed, was it your testimony that it would cost a Dollar a ton to haul the clay from the mine at Cannelton in 1951 to the plant?

A. No.

254 Q. What was your testimony as to that cost?

A. The only Dollar a ton that I can remember using this morning was the cost for unloading from railroad cars into trucks and transporting to a grinder or storage.

255 Q. How far is that from the railroad siding into your grinding and storage?

A. That would not be more than two blocks.

256 Q. How—Do you know how much it cost per ton to deliver clay from your mine to the bin?

[fol. 62] Mr. Travis: (For Pltf.) Now, if your Honor please, the plaintiff renews its objection. This is exactly the line of testimony that was excluded this morning.

Mr. Friesen: (For Deft.) I didn't ask what it was; I asked him if he knew, Mr. Travis.

Mr. Travis: (For Pltf.) May I, please? This was the exact line of questioning that was excluded from his testimony this morning on Mr. Friesen's objection. The witness

finally stated that he had no personal knowledge other than memory except for consulting the books.

The Court: Well, I don't know that this is quite true. You finally got this answer from your witness: that the cost of mining clay, per ton, in '51, including the transportation, to and from the plant and back to the mine, was $2.418.

Mr. Travis: (For Pltf.) Yes, sir, I did.

The Court: Is that right.

Mr. Travis: (For Pltf.) Yes.

The Court: I will overrule the objection.

257 Q. (By Mr. Friesen) Do you know the cost of hauling clay from the mine to the plant in 1951?

A. I would have to consult the company records for the exact cost.

258 Q. Where did you get the figure $2.41 per ton?

A. I got those from the company records.

259 Q. And do you recall making a computation by dividing thirty-eight thousand-some odd tons of clay into a figure of $91,374.15?

The Court: Excuse me. Was that some testimony? I don't recall the testimony. Is that some conversation on the side?

Mr. Friesen: (For Deft.) No. I am asking if that is the way he got the figure.

Mr. Travis: (For Pltf.) By doing what?

The Court: Read the question.

[fol. 63] Mr. Friesen: (For Deft.) By dividing the 38,000 into $91,374.15.

A. I divided 38,474 tons into $93,048.42.

(The defendant, for purposes of identification, handed the reporter a certain document for marking; and which was by said reporter marked Government's Exhibit B.)

260 Q. (By Mr. Friesen) Mr. Clemens, I hand you what has been marked for identification as Government's Exhibit B and ask you if you ever have seen that document before.

A. I don't recall seeing this particular one.

261 Q. What does this document appear to be?

Mr. Travis: (For Pltf.) May I see it, please? (Mr. Travis tendered document).

A. That is a profit and loss statement.

262 Q. (By Mr. Friesen) From what company?

A. I never got past reading the first line until Mr. Travis took it. (Witness tendered document.)

I saw the profit and loss statement for the company, but . . .

The Court: (Interposing) Is that the plaintiff?

The Witness: Yes.

The Court: All right.

A. (Cont'g) I saw the profit and loss statement for that year, yes, but I am not sure this is the same document I saw.

263 Q. (By Mr. Friesen) If I told you this came from the files of the Internal Revenue Service with relation to the Cannelton Sewer Pipe Company for 1951, would you recall having delivered that to the Internal Revenue Service?

A. I had nothing to do with the delivery.

[fol. 64] Do you know who prepares the profit and loss statements for your company?

A. Yes.

265 Q. Who is that?

A. Edward Clemens. He is in direct charge of it.

Mr. Friesen: (For Deft.) Mr. Clemens has looked at this document. Will counsel stipulate this is one of those prepared by Mr. Clemens?

Mr. Travis: (For Pltf.) Where did you get it?

Mr. Friesen: (For Deft.) From the files of the Internal Revenue Service.

Mr. Travis: (For Pltf.) I can't understand the form of this, why would it be submitted in this form. Any explanation in the file?

Mr. Friesen: (For Deft.) No explanation.

Mr. Travis: (For Pltf.) Why is it marked "Exhibit E"?

Mr. Friesen: (For Deft.) I don't know what that is.

Mr. Travis: (For Pltf.) Does that compare with our income tax return?

Mr. Friesen: (For Deft.) A great number of the figures do; not all of them.

Mr. Travis: (For Pltf.) Isn't there a letter of transmittal showing where it came from?

Mr. Friesen: (For Deft.) I don't find it. It was attached to the work papers.

Mr. Travis: (For Pltf.) I want to explain to your Honor the reason I want to be a little fussy about stipulating it is because the accountant for the plaintiff, at the request of the Internal Revenue Service in Indianapolis, made a great many computations for the convenience of the Revenue Service to which the plaintiff has not in any sense agreed, but were made on theories which the Revenue Service told [fol. 65] our accountants to use in analyzing the operating results for that year. Whether we are getting into something that could possibly be figures to which we don't agree, I don't know.

Mr. Friesen: (For Deft.) Your Honor, this is a copy of the same document. I am interested in these figures on mining expense, which are shown.

The Court: Why don't you call on counsel to stipulate what the mining expense was on the two figures? Otherwise, we would have to recess to let counsel check your instrument against their profit and loss.

Mr. Friesen: (Fort Deft.) His figure was only $2,000 higher. I am interested more in a breakdown than the total figure. $2,000 difference in mining expense does not make a substantial difference.

Mr. Travis: (For Pltf.) For many years after this case arose in the Revenue Service, the Revenue Service was contesting taking depletion on the end-product. Therefore, our accountants for the convenience of the Government, made mining costs which are now unrealistic in view of the Supreme Court decision; so, I certainly don't want to get in a point where we are stipulating anything that is unrealistic. Mr. Clemens has in his hand the statement of mining costs from which he testified (statement tendered to Mr. Friesen), and I would prefer . . .

The Court: (Interposing) Let the record show counsel for plaintiff has tendered to the Government counsel what

What, now, sir, in lieu of the stipulation of the proposed Exhibit B?

Mr. Travis: (For Pltf.) What are the two sheets which I just handed to Mr. Friesen?

Mr. Friesen: (For Deft.) Which we shall ask to be marked Government's Exhibit 'C' for identification.

The Court: All right, you may answer.

[fol. 66] The Witness: The one sheet covers a breakdown of clay costs for the fiscal year ending November 30, 1951, for the Cannelton Sewer Pipe Company.

The Court: Would you tender it to the reporter now and have her mark it?

(The defendant, for purposes of identification, handed the reporter a certain document, consisting of two pages, for marking, and which was by said reporter marked Government's Exhibit C.)

Mr. Friesen: (For Deft.) I apologize for the delay. I did not understand this was not a valid copy.

Mr. Travis: (For Pltf.) Was the offer of Exhibit B withdrawn?

Mr. Friesen: (For Deft.) I never offered it.

266 Q. (By Mr. Friesen) This "Motor Truck Hauling Expense," $0,017.73, is that the total cost of hauling the thirty-eight thousand-odd tons during the year 1951?

A. That is the motor truck expenses cost only.

267 Q. Now, have you any item on that list for overhead which is attributable to the mining operation?

A. I don't see it on here.

268 Q. Do you have any figure on that list for the amount of taxes on the property laid to the mine?

A. I don't see it on here.

269 Q. Is there any figure on that list showing the amount of investment in mining properties, or depreciation on mining properties?

A. Yes.

270 Q. Is that the total equipment that you had involved in the mine during that year, total depreciation on equipment that you had involved?

A. Inside the mine.

271 Q. Does not include any of the trucks' depreciation?

[fol. 67] A. No.

272 Q. Would the hauling cost for the trucks include any depreciation on the trucks?

A. I am not sure of that; I think it does. I would have to check the depreciation figures on the company records.

273 Q. There is no overhead or tax attributed to this particular operation, is that correct?

A. No property tax.

274 Q. Are there any taxes?

A. Payroll taxes.

275 Q. And how much are they?

A. $1711.55.

276 Q. Do you think that in computing the cost of obtaining materials that you should include in those costs the property taxes and the other items that I have included?

Mr. Travis: (For Pltf.) If your Honor please, the plaintiff will object to this line of questioning. This witness has already testified that he is not in the financial end of this business; that his brother, Edward, who is present in the court room and will be on the stand, handles all of the financial dealings, and I think we are going to waste a lot of time if you would reserve until Mr. Edward Clemens testifies anything you want about the finances of the company.

The Court: Overruled. You may answer.

A. Will you repeat the question, please.

The Court: Read the question.

(The reporter read the last preceding question as follows: 276 Q. "Do you think that in computing the cost of obtaining materials that you should include in those costs the property taxes and the other items that I have included?")

[fol. 68] A. My answer to that would be that this is our present accounting system.

277 Q. (By Mr. Frieson) So, it is just an accounting system; does not really reflect the cost of producing clay out of the mine?

A. It reflects the costs stated in this exhibit.

278 Q. And nothing more.

Mr. Frieson: (For Deft.) I now offer the Government's Exhibit C.

The Court: Consisting of two pages.

(Government's Exhibit C was offered in evidence at this time by Mr. Frieson.)

The Court: Any objection?

Mr. Travis: (For Pltf.) No objection. I think as long as it is being introduced in evidence, the Court should be told what the second sheet is.

279 Q. (By Mr. Friesen) You have only identified Sheet 1, which was the breakdown on clay costs of manufacture. What is Sheet 2, of Government's Exhibit C?

A. Sheet 2 is the average cost per ton for clay for the years 1952 through 1955, inclusive.

280 Q. Were they similarly computed the way this was computed?

A. Yes.

The Court: By "this" you mean Sheet 1?

Mr. Friesen: (For Deft.) Yes. I beg your pardon.

The Court: You are offering . . .

Mr. Friesen: (Interposing for Deft.) Government's Exhibit C into evidence.

The Court: Consisting of two sheets.

(Government's Exhibit C was re-offered in evidence at this time by Mr. Friesen.)

[fol. 69] The Court: Any objection?

Mr. Travis: (For Pltf.) No objection.

The Court: There being no objection, C is admitted, read, and exhibited in evidence.

(Government's Exhibit C is admitted and read into the evidence, and made a part of the record in this case, said exhibit being in the words and figures following, to-wit:)

(Here Insert.)

281 Q. (By Mr. Friesen) Mr. Clemens, do you know how much of an investment you had in the mine which you owned in 1951?

A. I don't, no, know the exact figure, no.

282 Q. Would Mr. Edward Clemens know that, you think?

A. You will have to ask him.

Mr. Travis: (For Pltf.) If you will be specific as to what you mean by "investment," Mr. Edward Clemens will produce any figure you want by telephone.

283 Q. (By Mr. Friesen) You testified that the reason that you started obtaining your clay from Kentucky was not because you were running out of clay. What was your reason?

A. The primary reason was so that we could produce a better product at a cheaper cost.

284 Q. You imply, Mr. Clemens, it was less expensive to get the clay from Kentucky.

A. I am not implying that necessarily, because you will note that there are some rather low costs, net clay costs on Exhibit C were given; but the clay which we obtained from Kentucky we can process by simpler methods.

285 Q. You were at the deposition of L. R. Chapman and heard him testify that for $10.00 an acre, sales price of the [fol. 70] land, a Dollar per ton, sales price for the clay, and 40 cents per ton, transportation costs to Owensboro, Kentucky, that he was able to furnish clay to the Owensboro Sewer Pipe Company in 1951. Would you in 1951, if you could have purchased clay for $1.40 a ton delivered in Cannelton, have been interested in buying it?

Mr. Travis: (For Pltf.) Just a minute. The plaintiff objects to the question, because the question is based upon a false premise, which I challenge Mr. Friesen with well knowing the witness did not testify that he sold clay at $1.00 a ton in his deposition, and he was very careful to avoid the tricky question which you tried to ask him then to get sales into the picture, and I will let the deposition speak for itself for the Court to see for itself.

Mr. Friesen: (For Deft.) If I used the term "sold" it was unintentional. I meant to say he mined and delivered in Owensboro, Kentucky, at the cost I described: $10.00 per acre for the land, and $1.40 for mining and delivery of the clay into Owensboro from the mine some 30 miles away.

286 Q. (By Mr. Friesen) Would you have been interested in purchasing clay for $1.40 a ton in 1951?

The Court: Just a minute. Do you have an objection?

Mr. Travis: (For Pltf.) I was going to, but I will let him answer.

A. In 1951 we were operating successfully with the clay which we were then using.

287 Q. And I put before you a proposition that you could have purchased the clay at a Dollar less per ton in 1951 and ask you if you were interested, or, would have been interested in purchasing sufficiently good clay in 1951 to have saved a Dollar a ton.

[fol. 71] A. I can't say at this date what I would have done in 1951, because, as I say, we were then operating successfully with the clay we had. We were not approached with any such proposition; so, therefore, I can't say what I would have done that many years back.

288 Q. There are a lot of economics involved in your testimony about transportation and purchases of clay. Now, without any tax advantage considered, wouldn't you be better off to buy your clay at $1.40 a ton than to mine it at $2.40 a ton?

A. You are putting a question to me that I would have some difficulty in answering on the spur of the moment. I don't like to answer questions of economics without having some figures behind it.

The Court: He is assuming the fact, Mr. Witness, for you, which you have a right to assume it is true. You don't have to look back. He is assuming for you, based upon evidence back in the record. Is that right?

Mr. Travis: (For Pltf.) I didn't hear the question.

The Court: Read the question.

(The reporter read the last preceding question as follows: 288 Q. "There are of a lot of economics involved in your testimony about transportation and purchases of clay. Now, without any tax advantage considered, wouldn't you be better off to buy your clay at $1.40 a ton than to mine it at $2.40 a ton?")

The Court: You can assume it is true. The oddity of the $1.40 figure you don't have any right to question that.

A. You are asking a question about the Year 1951, at which time the depletion law was in effect, is that correct?

289 Q. (By Mr. Friesen) I asked you to assume there would be no tax advantage to mining your own clay, as [fol. 72] opposed to buying your clay, and to use that as an assumption as you used my other statement as an assumption.

A. You are always better off to mine your own clay than to purchase, because you have the advantage of quality controlled by doing your own mining; therefore, I would assume that it would be better for us to mine our own clay than to purchase from a manufacturer or a producer over whom we have no control.

290 Q. Even if it would save you a Dollar a ton to do it that way, to purchase it?

A. That is a question that is difficult for me to answer without being, right at the time knowing exactly what we would be purchasing. There are cases where somebody could go scoop clay out of the field and sell it to us for $1.40 a ton and say it had equal qualities to that we were using out of our own mine at $2.40 a ton.

291 Q. But if you were purchasing material . . .

The Court: (Interposing) He hadn't finished the answer.

A. (Cont'g) Therefore . . .

292 Q. (Interposing) Excuse me.

A. (Cont'g) Therefore, I have to know all of the facts in the case before I could— It would be a very qualified statement to say that we would be interested in saving the money, just for the sake of saving the money, rather than losing control over our manufacturing process.

293 Q. Mr. Clemens, if I added the assumption that you could direct the miner to deliver to you certain bodies of coal, or, of clay, wouldn't your answer be that you would rather buy it at $1.40 a ton than $2.40 a ton produced?

A. I think you are trying to commit me to the purchase rather than mining, and as I say, that is a difficult question [fol. 73] to answer from just on the spur of the moment.

294 Q. Just assuming you get the same quality clay at $1.40 a ton. You could tell the miner—like you do now—"You dig that section right there and deliver it to me." Wouldn't you just as soon get it for $1.40 a ton delivered as to pay $2.40 a ton to mine it yourself?

A. I would just as soon mine it myself, I believe.

295 Q. And pay a Dollar extra a ton?

A. No. If the other fellow could mine it at $1.40 a ton, I would try to find some way to mine it for $1.40 a ton myself.

296 Q. All right. Is there any substantial difference between the quality of the product produced by the Owensboro Sewer Pipe Company and yours?

A. Are you asking me to read into the record an indictment of our competitor?

297 Q. No; I am asking you basically if you don't compete.

A. We compete in the same market, yes, sir.

298 Q. And he sometimes sells in that market that you are competing with him in, is that correct?

A. Yes.

299 Q. Do you know how far from your present mining operation Owensboro takes their clay and shale?

A. Roughly a mile or two.

300 Q. And is that in the same general clay deposit or vein that you are mining from?

A. The same geologic formation.

301 Q. Is that considered to be the Pennsylvanian?

A. Yes.

302 Q. I believe, Mr. Clemens, you testified that you had never had a fire clay test under Cone 19, is that correct?

A. I did not, sir.

[fol. 74] 303 Q. You made some statement concerning the lowest test you had on your fire clay. What was that statement? Do you recall?

A. The lowest test I have ever run has been Cone 19 on fire clay.

304 Q. When you say you have ever run are you including Bruce Williams Laboratories, that furnished this other example which you have introduced into evidence?

A. We have had them run samples for us; one fire clay and one shale.

(The Government for purposes of identification handed the reporter a certain document for marking, and which was by said reporter marked Government's Exhibit D.)

305 Q. (By Mr. Friesen) The reporter has marked for identification the Government's Exhibit D, a copy of a letter furnished the Internal Revenue Service, with a letter directed to the Internal Revenue Service, Mr. G. W. Snyder, Associate Chief. I ask you if you have ever seen that, or the original of that, document before.

A. I saw the original of it, yes.

306 Q. And you have testified that your fire clay has never had a Cone of less than 19. What does the Cone appear to be on that document?

A. Says on this document that the P.C.E. is Cone 17.

307 Q. Do you wish to change your testimony?

A. This was a test which was made and cone tested with the Bruce Williams Laboratories. Inasmuch as it was a

composite of fire clay and shale, we asked them to re-run it.

308 Q. Doesn't it state on the top of that it is fire clay?

A. Yes. And I did not take this sample. It was taken [fol. 75] by someone else at the plant, furnished to them, and we contested it, because it was a composite.

309 Q. How do you know it was shale in that test?

A. Because we later had a sample re-run.

310 Q. Of exactly the same material?

A. No; of the fire clay and shale from the mine.

311 Q. Now, there is a variation both laterally and vertically, I think as we discussed before.

A. Yes.

312 Q. Couldn't it be that the fire clay would have a Cone of 17 in spots and a Cone of 19 or 20 in other spots?

A. If the fire clay was contaminated with impurities, it could have.

313 Q. How can you tell whether this particular material is shale rather than fire clay?

A. I didn't say it was shale. I said it was apparently a composite or a mixture of the two and improperly sampled.

314 Q. Apparently—why do you say apparently?

A. Because when we later ran tests on the same material, or on the fire clay and shale taken at the same mining area, we got a P.C.E. of Cone 19 or 20.

315 Q. By running a test; not the same material, not the same sample?

A. No, sir.

316 Q. So this could be a perfectly good sample of fire clay, what you call fire clay, from the same face, but just had a different pyrometric cone.

A. I say if it was contaminated with impurities, it could have a lower P.C.E.

317 Q. I ask you how you know it was contaminated with impurities.

A. Because that is usually what happens when we get a low P.C.E. There are iron compounds in a clay which contaminate the clay.

[fol. 76] 318 Q. In order to get a high P.C.E. you would have to pick out a sample that didn't have any iron?

A. We have to take an average cross-section over the entire vein, as Dr. Murray told you in his testimony he did.

319 Q. How much iron shows up in that chemical analysis?

A. The iron oxide is 3.19 per cent.

320 Q. The example you gave us with the higher C one was 4.10. Would that indicate more or less iron?

Mr. Friesen: (For Deft.) May the record show he is looking at Plaintiff's Exhibit 15.

A. It has a higher per cent of iron oxide, but not significantly higher, and a comparison would also have to be made of all of the other impurities, the other oxides, which influence the maturing temperature and P.C.E. of the clay; for instance, in the one test it shows calcium oxide . . .

The Court: (Interposing) What test is that? Exhibit what?

The Witness: Exhibit D.

A. (Cont'g) Calcium oxide is shown 0.74, while in Exhibit 15 it is shown only as 0.19; so, there are other influencing factors on the P.C.E. of a clay.

321 Q. (By Mr. Friesen) But you can not testify of your own knowledge that this one which you furnished the Revenue Service, in connection with your claim for depletion allowance, was not a sample of what you call fire clay?

A. I did not take the sample, so I can't be sure of what it was.

Mr. Friesen: (For Deft.) May the record show this was furnished the Internal Revenue Service in connection with the percentage depletion computation.

[fol. 77] The Court: What do you mean by "this"? You are speaking of record.

Mr. Friesen: (For Deft.) I beg your pardon. The Government's Exhibit D.

Mr. Travis: (For Pltf.) Let the record show it is offered and admitted in evidence without objection.

Mr. Friesen: (For Deft.) I need to offer the letter, and take it out of the records, and so forth, to show this was attached to the letter sent to the Revenue Service.

Mr. Travis: (For Plftf.) The plaintiff stipulates that Government's Exhibit D was furnished to the Government's Internal Revenue Service by the plaintiff.

The Court: You are offering D?

Mr. Friesen: (For Deft.) I offer D in evidence.

(Government's Exhibit D was offered in evidence at this time by Mr. Friesen.)

Mr. Travis: (For Pltf.) No objection.

The Court: There being no objection, D is admitted, read and exhibited in evidence.

(Government's Exhibit D is admitted and read into the evidence, and made a part of the record in this case, said exhibit being in the words and figures following, to-wit:)

(Here Insert.)

322 Q. (By Mr. Friesen) Mr. Clemens, you are a ceramics engineer, are you not?

A. Supposed to be, yes.

323 Q. And as a ceramics engineer are you familiar with refractories?

A. Yes.

324 Q. What is a refractory?

A. That covers quite a varied field. There are hundreds of different refractories. Specifically which one do you want me to describe?

[fol. 78] 325 Q. I was asking for the definition of a refractory, if you have one.

A. A refractory is a heat-resistant material.

326 Q. You have testified you are a member of the American Society for Testing Materials. In 1957 they published a Manual of A.S.T.M. Standards on Refractory Materials. Are you familiar with this volume?

A. Not the 1957 volume; I am familiar with previous volumes.

327 Q. There is a definition for refractories that appears on page 192, of this volume. Would you read that and tell me whether you agree with that definition?

Mr. Travis: (For Pltf.) To which the plaintiff objects for the reason and unless Mr. Friesen will establish by this witness, or others, that we are concerned with refractory products, which we are not.

Mr. Friesen: (For Deft.) This is cross-examination, your Honor. I believe that it has relevancy.

Mr. Travis: (For Pltf.) This was gone into Saturday on our deposition, and Dr. Murray testified very clearly, and so will this witness, we are not concerned with refractory products. Sewer pipe is definitely not a refractory product.

The Court: And now your viewpoint. Just one at a time.

Mr. Friesen: (For Deft.) I am attempting to define the term, fire clay, your Honor, which I believe may need some light on it before this case is ended.

The Court: All right, overruled. You may answer.

Mr. Travis: (For Pltf.) I will not object to your asking for a definition of fire clay.

Mr. Friesen: (For Deft.) In due time.

A. You are asking me to read this definition?

328 Q. (By Mr. Friesen) And tell us whether you agree. [fol. 79] A. (Reading) "Refractories. In refractories the property of being resistant to softening or deformation at high temperatures."

329 Q. Do you agree with that definition?

A. For refractory products, yes.

330 Q. And turning to page 194, of the same volume, would you read the definition of low-duty fire clay brick, and tell us whether you agree with that definition?

A. (Reading): "Low-duty Fire Clay Brick. A fire clay refractory having a pyrometric cone equivalent not lower than 19 and a minimum modulus of rupture of 600 pounds per square inch."

331 Q. As a ceramics engineer, could you agree with that definition?

A. For refractory brick, yes.

332 Q. For low-duty refractory . . .

A. (Interposing) For refractory brick.

333 Q. Now, what other refractories are there than refractory brick?

A. Oh, there are glass pots, steel refractories, nozzles, ladles, refractories used in the aircraft industry, refractories used in ordinary household furnaces; of special shape there are just hundreds and hundreds of different varieties of materials called refractories.

334 Q. You called them "refractory." Would you call them "commercial refractory products"?

A. Yes.

335 Q. And you heard me ask Dr. Murray if he agreed with the definition of fire clay, which is reported in the A.S.T.M. C 71-51, and I believe he stated that he would not disagree with it. You have stated that you do not disagree with Dr. Murray. Does that mean you also agree with the definition of fire clay set forth by the A.S.T.M.?

[fol. 80] Mr. Travis: (For Pltf.) I suggest that the witness be furnished with the deposition rather than testifying blind.

Mr. Friesen: (For Deft.) I don't care, if you know the page number.

Mr. Travis: (For Pltf.) I don't; but instead of using your handwriting, why don't you give him the book?

Mr. Friesen: (For Deft.) I can give you the citation, if you find an error—I could not bring a copy of the book with me.

Mr. Travis: (For Pltf.) Show him the definition.

(Witness tendered definition in Mr. Friesen's handwriting.)

336 Q. (By Mr. Friesen) This definition, if you would read it into the record, and tell us whether you would agree or disagree with it.

A. I will read the definition. (Reading) "An earthy or stony mineral aggregate which has the essential constituent hydrous silicates of aluminum with or without free silica, plastic when sufficiently pulverized and wetted, rigid when subsequently dried, and of suitable refractoriness for use in commercial refractory products."

337 Q. Would you disagree with that definition?

A. This is a general definition of fire clay, and it is intended to cover refractory, commercial refractory products, —"commercial refractory products." There are other definitions of fire clays and there are other uses for fire clays, so I would say that fire clay is not restricted to commercial refractory products.

338 Q. But this definition would restrict fire clays to those materials which are suitable for use in making commercial refractory products, wouldn't it?

A. This definition does.

339 Q. Then you disagree with the definition?

[fol. 81] A. You have to define what grade or type of fire clay is being used before you can identify it with a product. Obviously, a low-duty fire clay could not make a high-duty refractory and it would not be good—very economical to use a high-grade fire clay for a low-duty product.

340 Q. But you are talking in terms of high duty and low duty. You already testified low duty has a pyrometric cone equivalent of 19 or better. Would you say the lowest fire clay suitable for making suitable refractories would be a pyrometric cone equivalent of 15?

A. Refractories, yes.

341 Q. What is your definition of fire clay?

A. It is very similar to that stated there, the definition which I just read into the record, except that it is not restricted to refractory products. Fire clay is essentially a mixture or aggregate of minerals made up primarily of hydrous aluminum silicates which can be formed with water into a plastic mass, dried and fired into a pre-determined shape, but not restricted to a particular product.

342 Q. The only way you differ with this definition, then, is in saying there are other products which a refractory may be used, refractory clay may be used for?

A. Yes.

343 Q. Would you still disagree with the definition that it must be suitable for use in making commercial refractories? I will grant that a refractory clay can be used to make common brick, but to be a fire clay, or refractory clay, must it not be suitable for use in making commercial refractories?

A. A fire clay does not necessarily have to be suitable for making refractories to be a fire clay.

344 Q. Then you disagree with the definition?

A. To the extent of the "use" term only.

[fol. 82] 345 Q. What does it have to be suitable for making, then?

A. Whatever product you are contemplating using it for. If you are going to use a fire clay for sewer pipe, it has to be of such a character and workability that it is capable of being used for sewer pipe.

346 Q. You can make sewer pipe out of shale, couldn't you, in some instances?

A. If the shale had the proper working characteristics.

347 Q. So, it does not need to be refractory working at all in sewer pipe, does it? Does not have to be a fire clay? A. It does not have to be a fire clay.

Mr. Friesen: (For Deft.) I have no further question.

Redirect examination.

Questions by Mr. Travis:

348 Q. Mr. Clemens, you have read into the record, at the suggestion of counsel for the Government, two definitions of fire clay. I will hand you a copy of Revenue Ruling 54-550, adopted by the Internal Revenue Service of the United States Treasury Department in December, 1954, and ask you to read that definition by the Internal Revenue Service.

Mr. Friesen: (For Deft.) I object to using this witness as a means of just reading into the record. I have no objection to its being in the record or otherwise.

The Court: Overruled. It may be preliminary to another question.

Mr. Travis: (For Pltf.) It is not preliminary, and I will read it myself to your Honor, if you prefer it that way.

The Court: All right.

[fol. 83] Mr. Travis: (For Pltf.) This, your Honor, is the Revenue ruling to which I referred, which was brought out by the Government practically four years after fire clay became a subject of depletion under the Internal Revenue Code. (Reading)

> "For the purposes of 1939 Code, Section 114" and so forth" as amended, a clay will be considered a refractory and fire clay if it has a pyrometric cone equivalent of 15 or higher. A clay having a pyrometric cone equivalent of less than 15 will not be considered a refractory or fire clay unless used or sold for recognized refractory purposes such as (but not necessarily restricted to) ladle lining."

Mr. Friesen: (For Deft.) Your Honor, may the record show the Revenue ruling was revoked some time ago.

Mr. Travis: (For Pltf.) I so stated.

349 Q. (By Mr. Travis) Mr. Clemens, you were asked on cross-examination at some length whether you would have purchased clay in Kentucky in 1951 from Mr. L. R. Chapman at $1.40 per ton, as against mining clay, which you did mine, in 1951 at the approximate cost of $2.41 per ton. Let me be sure about one thing. Was the clay which Mr. Chapman is now selling you accessible to your company in 1951?

A. No.

350 Q. Did Mr. Chapman at any time in 1951 offer to sell you any clay from Kentucky.

A. No.

351 Q. What kind of mining is it that Mr. Chapman does in Kentucky?

A. It is commonly described as "strip" mining."

352 Q. What kind of mining were you doing in Cannelton in 1951?

[fol. 84] A. We were doing underground drift mining.

353 Q. It is a fact or not that strip mining is a much cheaper operation than underground mining?

A. It usually is cheaper.

354 Q. Then is that one of the factors that made you decide to obtain your clay, starting in 1957, from Mr. Chapman's mine in Kentucky?

A. Two factors were involved. Primarily the greatest factor was the easier workability of the clay, and the fact that it could be mined at a more reasonable cost per ton of mined clay.

355 Q. How far back in your Cannelton mine were you in 1957?

A. Taking all entries into consideration, we had several miles of entries.

356 Q. Were you reaching a point where the cost of mining was increasing with the distance you penetrated into the mine?

A. The cost of hauling to the surface was increasing.

357 Q. Is the vitrified sewer pipe manufactured by the Cannelton Sewer Pipe Company a refractory product?

A. No.

358 Q. Now, with regard to some of this transportation problem you were questioned about, is there any difference

in the weight of a given mass of clay when it comes to the mine than when it leaves your plant as a finished product?

A. Yes, there is a loss in weight in manufacturing.

359 Q. Approximately how much is that loss?

A. Approximately—you mean of the dry clay?

360 Q. Yes.

A. From the dry clay to the finished product is approximately 8 per cent.

361 Q. Would there be any difference in your answer if I asked you to use the clay as it comes out of the [fol. 85] mine and the weight of the Number 1 sewer pipe? What would be the percentage of the loss of weight be using those?

A. There is a loss in weight of the clay, itself, as well as a loss in manufacturing—the floor loss, or loss by breakage, going through the dryers, and the loss by breakage or other defects in going through the firing process.

362 Q. What percentage would the loss be as it comes from the mine and as it leaves your plant as a Number 1 sewer pipe?

A. Probably a total of 16 to 20 per cent.

363 Q. Upon your hauling a finished product, you are not hauling near as much weight as the original clay when it came out of the mine?

A. No.

364 Q. Is it important when you enter a new mine, or enter upon a new place for obtaining your clay, that you be guaranteed of a supply for a considerable period of time in the future?

A. Yes.

365 Q. In 1951 did you have available to you any figures showing the extent of any clay pit in Kentucky that could supply you for some years to come?

A. No, we did not.

366 Q. Had you made in 1951 any research, drill tests, surveys, and other things that you have testified this morning you had to do, regarding any Kentucky clay?

A. We did some sampling.

367 Q. From any particular pit?

A. From a great number of locations in the State.

368 Q. Had you completed a survey to the extent that you knew of a clay which was suitable for your product?

A. No.

[fol. 86] 369 Q. At the same time you were carying on research in Kentucky for a period of five years prior to 1957, were you also prospecting in Indiana?

A. Yes.

370 Q. At the same time?

A. Yes.

Mr. Travis. (For Pltf.) That's all.

The Court: Recross?

Recross-examination.

Questions by Mr. Friesen:

371 Q. You state, Mr. Clemens, that the material in Kentucky was not accessible to you in 1951. Are you referring to the fact that you would have to carry it 17 miles rather than seven miles?

A. That, and the fact that we did not know whether or not the land under which the clay lies would be available.

372 Q. But that is all you mean by not being accessible?

A. There were no roads into the location at all.

373 Q. If I put in that presumption it would have taken 17 miles rather than seven, and the fact you didn't know if Mr. Chapman owned the land, or you didn't know who owned the land, with those two assumptions is that the reason you say it was not accessible in 1951?

Mr. Travis: (For Pltf.) I object. This is argument with the witness. The witness just gave another reason. He said there was no roads into it at all. That was not your question.

The Court: We have a three-way argument; overruled. You may answer and we will save time.

A. Will you state the question again?

374 Q. (By Mr. Friesen) Did you say there were no roads at all into the area?

A. Not where we were mining clay.

[fol. 87] 375 Q. How far from where you were mining clay was the closest road in 1951?

A. Probably four or five hundred feet.

Mr. Friesen: (For Deft.) I have no further questions.
Mr. Travis: (For Pltf.) Step down.

(Witness excused.)

The Court: We will have a recess at this time, gentlemen.

(Whereupon the Court was recessed at 3:25 p.m., and reconvened at 4:10 p.m., at which time the following proceedings were had:)

The Court: Call your next witness.

Mr. Travis: (For Pltf.) Your Honor, I have one more witness and a deposition. Mr. Friesen, on the other hand, has two gentlemen here from Brazil, who are short witnesses and would not take long and if it is all right with the Court, I would consent we go out of order so he might put his two witnesses on the stand.

The Court: All right.

Mr. Friesen: (For Deft.) I call Mr. John C. Hutchinson to the stand.

The Defendant, to maintain the issues on its behalf, offered and introduced the following evidence, to-wit:

John C. Hutchinson, a witness called on behalf of the defendant, being first duly sworn, testified as follows:

Direct examination.

Questions by Mr. Friesen:

1 Q. Give your full name, Mr. Hutchinson.
A. John C. Hutchinson.
[fol. 88] 2 Q. And where is your home?
A. Brazil, Indiana.
3 Q. And how are you employed or in business?
A. I am Secretary-Treasurer of the Ayer-McCarel Clay Company, Inc.

The Court: How do you spell that name?
The Witness: A-y-e-r M-c-C-a-r-e-l.

4 Q. (By Mr. Friesen) And where is the . . .

Mr. Travis: (Interposing for Pltf.) Is that a coal Company?

The Witness: Clay company.

5 Q. (By Mr. Friesen) And where is the plant of that company located?

A. It is located at Carbon, Indiana.

6 Q. How far is that from Brazil, Indiana?

A. Six miles.

7 Q. In what direction, approximately?

A. North of Brazil.

8 Q. Was—What does the Ayer-McCarel Company produce?

A. We manufacture structural facing tile, silo blocks, tank blocks, and filter blocks.

9 Q. Do you manufacture all of these products at your plant at Carbon?

A. Yes, sir.

10 Q. Do you have any other plants?

A. No, sir.

11 Q. What is the raw material from which you make these products?

A. Fire clay.

12 Q. And by "fire clay" what, specifically, do you refer to in the area around Brazil?

[fol. 89] A. Do you mean . . .

13 Q. (Interposing) What is it called?

A. From where it is mined.

14 Q. From where it is mined.

A. It is mined in open-strip mining.

15 Q. And do you know if it is associated generally with coal?

A. Well, this strata in the clay operation, Clay County, we have the overburden; if there is a *vien* of shale, the overburden, the hardpan; if there is a vein of shale, then the coal and then the clay.

16 Q. And do you know what this particular coal is called in your area?

A. In our area it is called top vein coal.

17 Q. Is that sometimes referred to as block coal?

A. Yes, sir.

18 Q. Does your company own a pit or mine for producing clay?

A. No, sir.

19 Q. From what source do you get the clay for your company?

A. We purchase our clay from the Turner Coal Company, Turner Coal and Clay Company.

20 Q. In the Year 1951, did you purchase all of your clay?

A. Yes, sir.

21 Q. Do you have any books and records available for the Year 1951?

A. No, I do not have.

22 Q. Were you associated with the company in 1951?

A. Yes, sir.

23 Q. In the same capacity as now?

A. Yes, sir.

[fol. 90] 24 Q. Have you at my request made some tabulations of current uses or purchases of clay for the years 1956 and '57?

A. Yes, I have.

25 Q. Now, based upon your knowledge of the business in 1951, can you refer to these figures and give an estimate as to how much clay you purchased in 1951?

Mr. Travis: (For Pltf.) To which, your Honor, the plaintiff objects for the reason that other than having company figures to me there could be no possible estimate based on '56 and '57, years which are not involved in our case here.

Mr. Friesen: (For Deft.) The man has been associated with the company for a number of years, including 1951, and based on his present production or use of clay, I am asking him to estimate what he probably used, admitting it is an estimate, in 1951. I think for the purpose of showing the market that these figures will be accurate.

The Court: Let's read the question again.

(The reporter read the last preceding question as follows: 25Q "Now, based upon your knowledge of the business in 1951, can you refer to these figures and give an estimate as to how much clay you purchased in 1951?")

The Court: Overruled.

Mr. Travis: (For Pltf.) May I ask a question?

The Court: No, sir; you may cross-examine. Overruled. You may answer. Yes or no, can you.

26 Q. (By Mr. Friesen) Can you make an estimate?

A. Yes, sir.

27 Q. Approximately, then, how much clay did you purchase in 1951?

A. My estimate, sir, would be 425 tons per week, or a [fol. 91] total for 52 weeks would be approximately 22,000 tons.

28 Q. And all of this was purchased?

A. Yes, sir.

29 Q. You mined none of it yourself?

A. No, sir.

30 Q. Mr. Hutchinson, we were in your plant yesterday, and picked up this from the yard. Can you tell if that is substantially the same appearance of clay that you converted into a ceramic product in 1951?

A. Substantially the same.

31 Q. Can you say there would be any variation from that in color, texture?

A. It could be a small variation in color or texture, depending upon the vein of the clay.

Mr. Friesen: (For Deft.) Your Honor, I don't want to burden the record by introducing this particular piece of ceramic into evidence. I think a comparison of color with the taxpayer's . . .

The Court: (Interposing) If this case goes up on appeal, how in the world will they decide whether I decided right?

(The defendant, for purposes of identification handed the reporter a certain object for marking, and which was by said reporter marked Government's Exhibit E.)

32 Q. (By Mr. Friesen) Do you know when this was manufactured?

The Court: Referring to Exhibit E?

Mr. Friesen: (For Deft.) Yes.

A. No.

33 Q. (By Mr. Frieson) Do you know that it was not manufactured within the past few months or years?

A. I wouldn't know, sir.

[fol. 92] Mr. Friesen: (For Deft.) I offer the Government's Exhibit E.

(Government's Exhibit E was offered in evidence at this time by Mr. Friesen.)

Mr. Travis: (For Pltf.) Mr. Hutchinson, do you know other than Mr. Friesen's statement that that came from your plant?

The Witness: Yes, sir, I do. That was picked up from our scrap pile as we walked by.

Mr. Travis: (For Pltf.) No objection.

The Court: There being no objection, Exhibit E is admitted and exhibited in evidence.

(Government's Exhibit E is admitted into the evidence, and made a part of the record in this case, said exhibit being in the words and figures following to-wit:)

(Here insert.)

34 Q. (By Mr. Friesen) I believe you testified, Mr. Hutchinson, that you produced filter blocks?

A. Yes, sir.

35 Q. Are you in competition with the Cannelton Sewer Pipe Company in the sale of filter blocks?

A. Yes, sir.

36 Q. What market area do you cover?

A. Indiana, Illinois, Ohio, Kentucky, Tennesee, Missouri, and throughout the South, and some localities in the west, and some in the east.

37 Q. Have you on occasions successfully competed with the Cannelton Sewer Pipe Company?

A. Yes, sir.

Mr. Friesen: (For Deft.) I have no further questions.

[fol. 93] Cross-examination.

Questions By Mr. Travis:

38 Q. Have you ben in the court room since the beginning of the trial, Mr. Hutchinson?

A. I came when the Court opened this afternoon at two o'clock.

39 Q. Have you heard the various definitions of fire clay that have been read into the record?

A. Yes.

40 Q. Which one did you use in saying yours was fire clay?

A. Would you state your question again?

The Court: Read the question.

(The reporter read the last preceding question as follows: 40 Q "Which one did you use in saying yours was fire clay?"

A. Well, sir, I would call it fire clay; I have always known it as fire clay. I feel the definitions that were given covered it.

41 Q. (By Mr. Travis) Do you know anything about the clay that Cannelton mined until they moved over into Kentucky?

A. No, sir, I do not.

42 Q. Have you ever been down in their plant?

A. No, sir, I have not.

43 Q. Fire clay has a meaning in your industry, doesn't it, that is not too technical?

A. Yes.

44 Q. Don't most vitrified products producers in this area of the United States use what you call fire clay?

A. In most cases they do.

[fol. 94] 45 Q. Did your company keep books during the Year 1951 that showed the tonnage of clay which you purchased?

A. Yes, they did.

46 Q. So you had books of accounting?

A. I do not now; due to a change in the personnel of our organization, some of our records were destroyed.

Mr. Travis: (For Pltf.) If your Honor please, the plaintiff now moves to strike the testimony of an estimate which the witness gave in view of the fact there is a better evidence.

Mr. Friesen: (For Deft.) Your Honor, he testified the records have been destroyed. We are not asking the figures . . .

Mr. Travis: (Interposing for Pltf.) That does not allow anybody to make . . .

The Court (Interposing) Let's don't interrupt.

Mr. Friesen: (Cont'g for Deft.) . . . relative to the proposition which the Government is submitting this evidence for, an estimate of tonnage based upon, an educated person's estimate of tonnage used in 1951 is certainly relevant and admissable.

The Court: Did you understand, Mr. Travis, in the inquiry of the witness that the records are no longer in existence?

Mr. Travis (For Pltf.) Well, I didn't gather that. I understood him to say due to change of personnel they were not available to him.

The Witness: You may have misunderstood me. I said due to the change in personnel of our organization, the records were destroyed.

Mr. Travis: (For Pltf.) It still is not my understanding a witness can estimate records because the records were destroyed.

The Court: Your objection was there were available, accurate records, and you should not rely on his estimate. [fol. 95] That was the reason given for your objection. You want to strike out?

Mr. Travis (For Pltf.) Yes, I say there is better evidence.

The Court: Where is it? I say it is not before me. The witness said the records were destroyed. Do you have any other reason for your motion to strike out?

Mr. Travis: (For Pltf.) I think it goes solely to the fact, although there were records which would have proved exactly, I think that destroys the possibility of any witness estimating what those records would have showed.

The Court: All right, your motion will be denied. Any further questions? Does the Government have any further questions?

Mr. Travis (For Pltf.) I have some further questions; excuse me, your Honor.

47 Q. (By Mr. Travis) Your company filed an income tax return for the Year 1951 with the Federal Government, did it not?

A. Yes, sir.

48 Q. Is a copy of that return available to you?

A. Yes, sir.

49 Q. Could you reconstruct from that information the tonnage used?

A. It would show the clay purchased for that year.

50 Q. And you say that is available?

A. That would be available, sir.

Mr. Travis: (For Pltf.) Well, the plaintiff now renews its motion to strike out the estimate made by the witness for the reason that the records are available.

Mr. Friesen (For Deft.) Your Honor, I return to my contention: The reason and purpose we are offering this evidence, this is a—May I ask a couple of questions to show the basis of his estimate?

[fol. 96] The Court: All right.

Mr. Friesen: (For Deft.) How much clay did you purchase in 1956 according to the books and records of the corporation?

The Witness: In 1956 we purchased 20,722 tons.

Mr. Friesen (For Deft.) And in 1957, Mr. Hutchinson?

The Witness: 22,676 tons.

Mr. Friesen (For Deft.) Has your production between the Year 1950 and the Year 1957 varied substantially?

The Witness: It has been very uniform.

Mr. Friesen: (For Deft.) And did this knowledge of the uniformity of your production, is it the basis for your estimate which you have stated? Is that correct?

The Witness: Yes, sir.

The Court: Overruled, the motion is overruled.

51 Q. (By Mr. Travis) The only product that you made similar to the one made by the Cannelton Sewer Pipe Company is filter block?

A. That's right, sir.

52 Q. That is a rather large item of your production, is it not?

A. Yes, sir.

53 Q. Do you know of your own knowledge that is a small item in the Cannelton Sewer Pipe Company's production?

A. I didn't get the question.

54 Q. I say, do you know of your own knowledge that is a small item in the Cannelton Sewer Pipe Company's production.

A. Well, I wouldn't have any records to substantiate my statement other than I am personally acquainted with Mr.

Gene Clemens and Mr. Ed Clemens, and they told me their [fol. 97] tonnage on filter blocks has not been a large item. I could not prove the statements, no.

55 Q. Did you use any of the clay which you purchased in 1951 in the manufacture of vitrified sewer pipe?

A. No, sir.

56 Q. Do those records, which are not now available to you, also show the price you paid for this clay in 1951?

A. They would if I had them.

57 Q. From your general knowledge of the ceramic industry in Indiana, Mr. Hutchinson, would you say it was economically feasible for the Cannelton Sewer Pipe Company to buy fire clay in Brazil and haul it to Cannelton and make from it vitrified sewer pipe, vitrified clay sewer pipe?

A. Well, I am not familiar with their operating costs, but it would seem to me that it would be rather expensive. That would be my opinion in the matter.

58 Q. Assume that they had available to them in 1951 a mine containing suitable clay and shale for the manufacture of sewer pipe, which was one and one-half miles from their plant. Would you think it was economically feasible for them to buy clay in Brazil and haul it to Cannelton for their production?

A. I would not be familiar with their operating conditions or costs.

59 Q. Have you ever been engaged in mining clay at all?

A. No, sir. Our firm was at one time, but they are no longer engaged in it.

60 Q. When did they quit that?

A. Late '45 or early '46.

The Court: Assume he had to pay these freight charges in your hypothetical question. I will give them to you in [fol. 98] a minute . . . Freight rate, $4.45 per ton, plus 3 per cent Federal tax, and another rate of $8.60 per ton, plus 3 per cent tax.

61 Q. (By Mr. Travis) Mr. Hutchinson, assuming the transportation rate from Brazil to Cannelton, Indiana, was $4.40 cents per ton . . .

The Court: (Interposing) 45 cents.

Q. (Mr. Travis con'tg) . . . $4.45 per ton, plus 3 per cent freight tax, would you say it was economically feasible for the Cannelton Sewer Pipe Company to buy clay in Brazil and haul it to Cannelton?

A. I would not be familiar with the cost of their operation and the cost of their finished product, and that would be—that would govern.

62 Q. Well, assume in adidtion, then, their cost of mining clay from their own mine in 1951 averaged $2.41 per ton, now what would be your answer?

A. Well, again, that would still be the policy of their production.

63 Q. You just don't want to answer that question, do you?

A. Well, I am not familiar with their business.

The Court: Let's ask him about his business, whether he would buy it from Cannelton.

64 Q. (By Mr. Travis) Mr. Hutchinson, what do you pay now for your clay in Brazil?

A. $1.75 a ton.

65 Q. Unloaded in your plant?

A. Delivered to our bin.

66 Q. All right, assume you could purchase from Cannelton Sewer Pipe Company clay suitable for your manufacturing as you now carry it on, would you purchase that clay from them at $1.75 and haul it to Brazil?

[fol. 99] A. I would purchase from our local concerns.

67 Q. Yes, in preference to hauling it any great distance at all. In fact, you don't haul it anyhow, do you?

A. About a mile and one-half or two miles.

68 Q. Your price is delivered into your plant?

A. That's right.

69 Q. So, you do no hauling?

A. We do no hauling.

70 Q. Actually, Mr. Hutchinson, it would not be economically feasible for you to buy clay in Cannelton with the freight rates I have given, even if it was given to you, would it?

A. That would depend entirely upon the product I was making and my production.

71 Q. I say in your production and similar clay to what you are using right now.

A. I don't know, sir.

Mr. Travis: (For Pltf.) That's all.

The Court: What do you mean, you don't know? You are Secretary-Treasurer of this organization. If you got the same price, the same costs, and you had to pay $4.45 freight rate, could you compete with these other businesses?

The Witness: That would depend entirely upon your production costs.

The Court: You know what your production costs are right now, don't you?

The Witness: Fairly close.

The Court: Assuming they are the same, could you absorb another $4.45, plus 3 per cent freight tax?

The Witness: I still would patronize the local concerns.

The Court: Suppose you could not get it there; suppose you couldn't get it at Brazil, and had to buy it [fol. 100] down in Cannelton and had to pay $4.45 more than you are now, plus 3 per cent freight tax could you compete in the market?

The Witness: Well . . .

Mr. Friesen: (Interposing for Deft.) Could we add in the Chicago market, your Honor?

The Court: The market he has named.

The Witness: Well, it would make our competition pretty hard, because we would have a hard time securing business.

The Court: All right, redirect?

Mr. Friesen: (For Deft.) I have no further questions.

Mr. Travis: (For Pltf.) That's all.

(Witness Excused)

Charles N. Smith, a witness, called on behalf of the defendant, being first duly sworn, testified as follows:

Direct examination.

Questions by Mr. Friesen:

1 Q. Give your full name to the Court, Mr. Smith.

A. Charles N. Smith.

2 Q. And where do you reside?

A. Brazil, Indiana.

3 Q. And where are you employed or in business?

A. G. and F. Corporation.

4 Q. And what is the business of the G. and F Corporation?

A. We are principally coal miners, strip coal miners.

5 Q. What is your position with that company?

A. Secretary-Treasurer.

6 Q. Do you also sell clay, meaning the corporation of which you are the Secretary-Treasurer?

A. We do.

[fol. 101] 7 Q. And in 1951 did you sell clay?

A. We did.

8 Q. Have you at my request taken from the books and records of the corporation the tonnages of clay which you sold in 1951?

A. I have a statement prepared under my direction.

9 Q. And were these statements prepared from the books and records of the corporation?

A. They were.

10 Q. To whom did you sell clay in 1951?

A. In the Year 1951 we sold clay to the Brazil Clay Company, Brazil Hollow Brick and Tile Company, the then National Fireproofing Company, and the American Vitrified Products Company.

The Court: Are they all in Brazil, Clay County Area?

The Witness: They are.

Mr. Travis: (For Pltf.) What was it? National what?

The Witness: At that time National Fireproofing Company.

11 Q. (By Mr. Friesen) Is that now called "Natco"?

A. Now called Natco Company.

12 Q. Now, do you have the figures with you of the amounts sold to each of the companies in 1951?

A. I do.

13 Q. How much clay did you sell to the Brazil Clay Company in 1951?

A. Our 1951 sales, Brazil Clay, 52,609.47 tons.

14 Q. And the Brazil Hollow Brick and Tile?

A. 14,371.95 tons.

15 Q. And to the National Fireproofing Company?

A. 20,062.55 tons.

16 Q. And to the American Vitrified Ceramic Company?
[fol. 102] A. American Vitrified Products, 34,211 tons.

17 Q. Do you know what the American Vitrified Products Company makes?

A. I believe they make sewer pipe.

18 Q. Do you have a total figure of your sales during that year?

A. Our sales for that year, tonnage sales, was 121,318 tons.

19 Q. Now, from what source did that clay come?

A. That came from our open-cut mining pits where we had deposits of Brazil block coal, and clay was under the block coal.

20 Q. Now, do those figures include any shale?

A. Yes, it includes shale.

21 Q. Which of the figures included shale?

A. The figures for National and American Vitrified contained some shale.

22 Q. Would you give the amounts, please?

A. I can not break them down specifically, but the 121,318 ton total for the year, 14,247 ton of that total was shale.

23 Q. And from what source did you get that figure?

A. From our records and from the report to the Bureau of Mines of clay and shale produced in 1951.

24 Q. What do you call the clay which you sell? What typical name do you put on this underclay?

A. Well, in our report in 1951, and the previous years to that, and the years before that, we have put it under the heading "Slip Clay."

25 Q. Is that what it is generally referred to as?

A. Probably, but in the nomenclature given here, we saw no other place to put it.

26 Q. Do you know what slip clay is?

A. No, I do not.

27 Q. All the clay and shale which you mined, came from underneath the block coal, is that right?
[fol. 103] A. That's right.

28 Q. Do you have a trucking opertaion presently connected with your company?

A. Yes.

29 Q. How many trucks or approximately how many does the company own and operate?

A. At the present time in the neighborhod of 35 units.

30 Q. And in 1951 do you know how many you would have had?

A. That would be a larger number, due to the change in our trucking industry; would possibly be in the sixties.

31 Q. What is the furthest point your company has transported the clay you sell?

A. The furthest point to which we ever transport has occurred in the last two years trucking clay to Hobart, Indiana, Natco.

32 Q. What part of the State is that?

A. Northern part.

33 Q. How far is that from Brazil?

A. Round trip, 330 miles.

34 Q. One way would be 165 miles?

A. That's right.

35 Q. What do you deliver to them?

A. We deliver clay to them.

36 Q. No shale?

A. No shale.

37 Q. You say Natco?

A. That is National at Hobart.

38 Q. Do you know what they produce at Hobart?

A. I have never been in Hobart. I understand they produce conduit, but I don't know the fact.

39 Q. Have you been associated with the trucking business in any way?

[fol. 104] A. Only insofar as keeping the records.

40 Q. Do you know the ton-mile cost of transporting clay?

A. At what period of time, sir?

41 Q. Well, if you know, in 1951.

A. In 1951 our operations of trucking are primarily concerned with the sale of coal. Our trucking operations are not done to make a profit; they are instant to the sale and distribution of our coal. The clay is actually a by-product with us. Most of our revenue is from the sale of coal, and our per-ton cost of transporting both our coal and clay within a four-or-five-mile area of Brazil was 80 cents a ton on a ton-mile basis. On the number of miles we were hauling the material, it would be about 1.8 cents.

42 Q. Per ton mile?

Mr. Travis: (For Pltf.) I didn't get the distinction between the 80 cents and the 1.8 cents.

The Witness: 80 cents a ton over-all, regardless of . . .

Mr. Travis (Interposing for Pltf.) And 1.8 cents per ton mile?

The Witness: Yes.

43 Q. (By Mr. Friesen) Do you know if you could make a profit on shipping at 1.8 cents per ton mile?

A. On the basis our operations were incidental to getting the product, and we were making a profit on the sale of the product, I don't believe you could make a profit on 1.8 cents.

44 Q. That was strictly the cost?

A. That was strictly the cost.

45 Q. Would the transportation of coal per ton mile be substantially different from the transportation of clay per ton mile in your opinion?

A. No.

[fol. 105] Mr. Friesen: (For Deft.) That's all. I have no further questions.

The Court: Cross-examine.

Cross-examination.

Questions by Mr. Travis:

46 Q. Mr. Smith, let's get this ton mile straightened out. You said 80 cents per ton for a four-or-five-mile haul?

A. That's right.

47 Q. How do you get 1.8 cents per ton out of that?

A. Well, sir, what are you going to start with, the factor, as your ton load? This thing can vary. I think we have to have a decision as to the factor, because some individuals will haul with trucks which will haul five tons.

48 Q. How did you arrive at the 1.8 cents per ton from the figures you gave of 80 cents per ton for a distance of four or five miles? Now, give me your factors, if you have any there. It seems like simple arithmetic to me.

A. Our trucks will haul, in 1951 will haul an average of 11 to 12 to 13 ton per load.

49 Q. What has that got to do with ton mile?

A. If you had 11-or-13-ton load, and 80 cents a ton, we would have $9.60 for taking a 12-ton load.

50 Q. Where do you work the ton mile in here? You have not used any miles in your calculation.

A. I divided the number of miles we were operating.

51 Q. All right. Let me ask you if the cost—if it cost you 80 cents per ton to transport one ton four miles, isn't that 16 cents per ton mile, 20 cents per ton mile?

A. If our cost were 80 cents per ton. . .

52 Q. (Interposing) Could you answer my question? It is simple arithmetic. Can you divide four into eight and come out with two?

[fol. 106] A. If you divide four into eight, you will come out with two.

53 Q. If you divided four miles into 80 cents, you come out with 20, don't you?

A. Well, apparently you and I are figuring ton mileage different, sir.

54 Q. I wish you would explain how you figured it.

Mr. Friesen: (For Deft.) Your Honor, I missed the number of miles his average run was. How far did you say your average run was?

The Witness: Our average point of delivery is four to five miles.

The Court: You have a question before you now, Mr. Witness. Will you explain to him your ton mile of 1.8: give your factors, and your reasons for that?

55 Q. (By Mr. Travis) Have you a calculation you made?

A. I am looking on the back of my information to see where I made the calculation. I don't have it here, sir.

The Court: Do you want to correct your ton-mile figure there, or do you have some other information?

The Witness: I would want to correct it, yes, if after checking it through it is incorrect.

Mr. Friesen: (For Deft.) May we ask him to check this, and if he wants to change that, I would be happy to stipulate, rather than calling him back tomorrow as to what his figure is, if it is 20 cents per ton mile; otherwise, I would be glad to call him back to explain his computation. He obviously does not have the figures with him.

Mr. Travis: (For Pltf.) I would be glad to proceed with this cross-examination.

56 Q. (By Mr. Travis) Would you take your pencil out? [fol. 107] The Court: You proceed with your cross-examination.

57 Q. (By Mr. Travis) Now, then, it cost you 80 cents per ton to haul coal?

A. And/or clay.

58 Q. Then you haul it four miles?

The Court: Or five, he said.

Mr. Travis: (For Pltf.) I have to use one; you can't give both of them.

59 Q. (By Mr. Travis) Use the example four miles. Now, how much per ton mile does it cost you to haul clay on those two figures?

A. Well, if you base it on those two figures, it would be 20 cents, sir.

The Court: You proceed with your cross-examina-

The Court: Redirect?

Redirect examination.

Questions By Mr. Friesen:

60 Q. Mr. Smith, do you believe the figure that you have given, 1.8, to be correct based on the computation you made at your office, or do you think it should be .18?

The Court: Might I suggest was your 80 cent figure for 12 tons, four miles or five miles, or 80 cents per ton?

The Witness: Our 80 cents per ton for four or five miles.

Mr. Friesen: (For Deft.) I have no further questions, but I would like to have the opportunity to recall Mr. Smith, if he finds . . .

The Court: (Interposing) Why don't you move that at that time?

[fol. 108] Mr. Friesen: (For Deft.) I have no further questions.

Mr. Travis: (For Pltf.) That's all.

The Court: Was there any evidence here, Mr. Travis, from your first witness—before this witness here leaves the room—as to the size of the coal vein in the Cannelton Area there in 1951 above the clay and shale in the mine?

Mr. Travis: (For Pltf.) Let me see if I understand you there. Mr. Clemens testified that the average vein of fire

clay, which laid immediately under the coal, was six foot and shale, two to four feet, and average, three feet. Sixty-forty was the ratio.

The Court: But he said something about a coal layer. How about that?

Mr. Travis: (For Pltf.) But they don't take any coal out.

The Court: I understand. But what was it? Did he answer that?

Mr. Travis: (For Pltf.) I don't believe he answered that.

(To Mr. E. C. Clemens) Do you know how thick the coal is above your fire clay?

Mr. E. C. Clemens: About 12 inches.

The Court: The Court would be interested in the expert witness that left the stand, if you inquire of him, ask him a hypothetical question if he could make a profit at his figure of selling this by-product, if he had to mine two feet of coal, 24 inches of coal, down in the Cannelton Area.

Mr. Travis: (For Pltf.) I purposely didn't go into that. I would be glad to, if your Honor wishes to be informed.

Mr. Friesen: (For Deft.) Your Honor, the Government [fol 109] will offer to show the people are mining clay in the Brazil Area without any coal.

Mr. Travis: (For Pltf.) Mr. Smith, will you take the stand, again?

The Court: I don't want to insist upon it, if it is not within your strategy.

Mr. Travis: (For Pltf.) No.

CHARLES N. SMITH, a witness on behalf of the defendant, having been recalled to the stand, testified further as follows:

Further Cross-examination.

Questions By Mr. Travis:

61 Q. How much tonnage of coal did your company mine in 1951?

A I don't have those figures here, because they were not requested of me; but in our years '50, '51, and '52, the figures exceeded, clay figures exceeded the coal.

62 Q. Yet you say the clay is a by-product of your coal business?

A. That's right.

63 Q. You are intentionally in the coal business?

A. We sell the clay we have a demand for, the local companies want, but, primarily, we are strip miners of the coal.

64 Q. What do you do with the coal above the clay or shale?

A. If the companies want it, we sell it. There is very little sale in our territory.

65 Q. You just have to dump and pile it?

A. That's right.

66 Q. And the fire clay that you sell lies directly under the coal?

A. Yes, the clay we sell is underneath the coal.

[fol. 110] 67 Q. What is the thickness of your coal vein generally?

A. Generally runs 36 to 40 inches.

68 Q. What is the thickness of the fire clay?

A. Anywhere from four to six feet.

69 Q. As long as you have to take off the coal for your primary coal business, you can mine that fire clay very cheaply, can you not, because your equipment is right there?

A. When we are through with loading coal, the clay is exposed and all we have to do to get it out is put the loading shovel in and scoop it up.

70 Q. Otherwise, it would not be worth a nickel to you, would it?

A. No.

71 Q. Do you have any figures, comparative figures, on the dollar sales in 1951 of clay and coal?

A. I have them in my brief case.

72 Q. Would you get them, please?

A. (Witness gets data.) In the Year 1951, our coal sales were $650,414. Our clay sales were $194,198.

73 Q. What is your estimate of how much clay, by tons, you mined in 1951 more than coal?

A. I would say in the neighborhood of 10,000 tons.

74 Q. Can't you give a pretty good guess of the number of the tons of coal from the gross figure?

A. Yes, I would say that is roughly 110,000 tons.

The Court: What is the size of your Brazil block coal vein there?

The Witness: In height it would run 36 to 40 inches.

The Court: Could you economically mine that coal and the clay by-product if it was a 24-inch vein?

The Witness: Again that would get into the question of what is the nature of the overburden above the coal. Is [fol. 111] it easy digging or is it rocks we have to shoot?

The Court: Suppose it is the same as you have there.

The Witness: Our profits would be narrowed down considerably.

The Court: Could you economically do it?

The Witness: We could.

The Court: All right.

75 Q. (By Mr. Travis) You don't know anything about clay, you say?

A. No.

76 Q. What did you sell that clay for in 1951, average?

A. Our clay was all sold at one standard price, $1.60 a ton delivered.

77 Q. Delivered how far?

A. Four to five miles.

78 Q. Now, this clay that you hauled up to Hobart, you didn't deliver it up there for $1.60, did you?

A. Oh, no, sir.

79 Q. What did you charge to deliver up there?

A. For the delivery, or the delivered price on the clay do you wish?

80 Q. I guess either one.

A. The delivered price of clay to Hobart, delivered in their bin, $5.65.

Mr. Travis: (For Pltf.) That's all.

Further Redirect examination.

Questions By Mr. Friesen:

81 Q. Mr. Smith, how did you compute the figure, $5.65, to charge the people in Hobart?

A. To arrive at that figure, Hobart asked if we could supply them with clay. We told them we could. We de-

termined what the rail competition was to get into Hobart. [fol. 112] We did some figuring as to what they would expense they would have to go to to unload it out of the railroad car, which necessitated the use of public clam shovel; would have to have a truck to load it from the railroad car into the truck, and take it over to their bin. Combining all those factors, we added to it f.o.b. price we wanted.

82 Q. In other words, you charged them what the traffic would bear, is that right?

A. That's right.

Mr. Friesen: (For Deft.) I have no further questions.

Mr. Travis: (For Pltf.) That's all.

The Court: All right, sir.

(Witness excused.)

The Court: Call your next witness.

Mr. Friesen: (For Deft.) We would call our other witnesses tomorrow. I would like to request the gentlemen be excused.

Mr. Travis: (For Pltf.) Yes.

Mr. Friesen: (For Deft.) Do you want them back tomorrow?

Mr. Travis: (For Pltf.) No.

The Court: It has reached the hour of five o'clock. Are there any other witnesses, Mr. Travis, that you have you would like to resolve here this evening?

Mr. Travis: (For Pltf.) No, your Honor. My other witnesses will remain over tonight.

The Court: I recommend that you consider identifying the exhibits of shale here. You have a lot of testimony in the record about it.

We will stand adjourned until 9:30 tomorrow morning.

(Whereupon the Court was adjourned at 5:00 o'clock p.m. to reconvene March 12, 1958, at 9:30 o'clock a.m.)

[fol. 113] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF INDIANA, INDIANAPOLIS DIVISION

Cause No. IP 57-C-163

CANNELTON SEWER PIPE COMPANY, a corporation, Plaintiff,

vs.

UNITED STATES OF AMERICA, Defendant

Indianapolis, Indiana, March 12, 1958. 9:45 o'clock a.m.

(The Court met pursuant to adjournment, and the trial was resumed as follows:)

The Court: Good morning, gentlemen. Call your first witness.

The Plaintiff, to further maintain the issues on its behalf, offered and introduced the following testimony, to-wit:

EDWARD F. CLEMENS, a witness called on behalf of the plaintiff, being first duly sworn, testified as follows:

Direct examination.

Questions By Mr. [redacted]:

1 Q. State your name and place of residence, please.

A. Edward F. Clemens, Cannelton, Indiana.

2 Q. And what is your occupation?

A. I am President of the Cannelton Sewer Pipe Company.

3 Q. How long have you been connected with that company?

A. 42 years.

4 Q. How long have you been the President?

A. 13 years.

[fol. 114] 5 Q. How old is the Cannelton Sewer Pipe Company?

A. The Cannelton Sewer Pipe Company was organized in 1908, and construction of the plant was begun, and we began operations in August, 1909.

6 Q. And have the products manufactured been substantially the same ever since that date?

A. They have.

7 Q. Your principal products?

A. Vitrified sewer clay pipe, flue lining, wall coping, and some filter block.

8 Q. What were the net sales of manufactured products of the Cannelton Sewer Pipe Company in the fiscal year ending November 30, 1951?

A. I will have to get the evidence to refresh myself here. (Witness tendered data). Net sales of manufactured products, as shown by our revenue report, were $1,409,145.66.

9 Q. In connection with that figure that you have just given, it is true, is it not, that we have had a discussion with Mr. Friesen this morning as to the possible inaccuracy which will be corrected by your accountants and the Revenue Service?

A. That is correct.

10 Q. But substantially that is the amount, is that right?

A. Yes.

11 Q. That is the amount that was computed by your C.P.A.'s?

A. That is correct.

12 Q. And will be corrected.

A. Yes.

(The plaintiff, for purposes of identification, handed the reporter certain documents for marking, and which were by said reporter marked Plaintiff's Exhibit 18-Part 1 and Plaintiff's Exhibit 18-Part 2.)

[fol. 115] 13 Q. (By Mr. Travis) I hand you what has been identified by the reporter as Exhibit 18, Parts 1 and 2, consisting of six pages, and ask what that is.

A. This is a letter from the Internal Revenue Department, relative to our claim for depletion allowance for the years ended November 30, 1951 and the carry-back on November 30, 1950.

14 Q. That letter, together with the computations attached, was from the Cincinnati Region, Appellate Division, of the Internal Revenue Service, is that correct?

A. That is correct, yes, sir.

15 Q. At Indianapolis.

A. Yes.

Mr. Travis: (For Pltf.) Plaintiff offers Exhibit 18 in evidence.

(Plaintiff's Exhibit No. 18 was offered in evidence at this time by Mr. Travis.)

Mr. Friesen: (For Deft.) I object to the admission of this unless it is shown to be relevant to the problem before us. I believe we have two basic questions of fact here. I would like to know what relevancy it has.

Mr. Travis: (For Pltf.) The relevancy that it has, your Honor, is that in the computations made by the Revenue Service on which the final tax of the plaintiff was assessed, says, has a computation called "Fire clay."

Mr. Friesen: (For Deft.) Your Honor, I don't believe it is relevant to show the Government has changed its position, but if that is relevant, why we should also like the opportunity to show they have changed their position several times in the course of coming to task.

The Court: Well, the objection will be overruled and Exhibit 18 will be admitted and read in evidence.

[fol. 116] (Plaintiff's Exhibit 18-Part 1 and Plaintiff's Exhibit 18-Part 2, a total of six pages, are admitted and read into the evidence, and made a part of the record in this case, said exhibits being in the words and figures following, to-wit:)

(Here Insert.)

16 Q. (By Mr. Travis) Mr. Clemens the computations attached to Exhibit 18, are those the final computations on which the tax was assessed against your company for that year by the Internal Revenue Service?

A. They are.

17 Q. Calling your attention to page 2, of Part 2, of Exhibit 18, in Schedule 2 there is shown a determination of the deduction for percentage depletion as computed by the Revenue Service. Is that true?

A. That is true.

18 Q. What two classes of minerals are shown on that exhibit as being allowed percentage depletion?

A. Fire clay and shale and tile clay.

19 Q. Can you tell, Mr. Clemens, what the theory used by the Revenue Service was in computing the percentage depletion for that year, the Year 1951?

A. The . . .

The Court: Let the record show the witness is examining Exhibit 18.

A. (Cont'g) The Revenue Department allowed 15 per cent on sales of fire clay, which amounted to $484.74. They allowed 5 per cent on a valuation they set up for the gross income from mining, which, as I recall it, included the processes up to and including the grinding for use in a pug mill or wet pan. They did not beyond that point. And that amount of gross income which they set up was $233,747, on which 5 per cent was allowed.

[fol. 117] 20 Q. Your company sells some of its clay in the form of ground fire clay. Is that true?

A. That is correct.

21 Q. What is the ground fire clay?

A. The ground clay which we sold is the material that has been ground and screened to a fine powder, and is used in laying up refractory materials.

22 Q. What were the total tons of clay mined by your company in the fiscal Year 1951?

A. 38,474 tons.

23 Q. And how much of that was sold in the form of ground fire clay?

A. 79.625 tons, practically 80 tons.

24 Q. And what was the price which your company received for those 79.625 tons?

A. $22.88 per ton.

25 Q. What was the total income, gross income, from those sales?

A. I do not have that here. I would have to refresh my memory on that. I have the net amount. But it is about $1822.00, as I recall it. (Witness tendered document.) No. It is $1822.45. That is the gross.

26 Q. That was the total?

A. That was the total sales' price.

27 Q. Out of the Million Four Hundred Thousand net sales for the company for that year?

A. That's right.

28 Q. Does your company also have pending with the Internal Revenue Service claims for refund for the year following 1951?

A. We do.

29 Q. Have those—No decision has been rendered on any of those, has it?

A. No final decision.

30 Q. But taxes have been assessed by the Internal Revenue Service?

[fol. 118] That's correct.

31 Q. For each of the years since 1951?

A. That is correct, up to and including 1955.

32 Q. What, if you know, was the theory used by the Revenue Service in assessing your taxes and computing your percentage depletion for the fiscal Year 1952?

A. In 1952 the sales were allocated as between mining and manufacturing, and the mining cost was carried up to the point where the clay was ground and screened and ready for use in the wet pan. To that sum was added an overhead which consisted of a fixed portion of the administrative general expenses and the factory overhead, which was properly allocable to that particular percentage of our costs.

33 Q. In other words . . .

A. (Interposing) On that basis, they allowed, as I recall it, 15 per cent on 60 per cent of the sales, and 5 per cent on 40 per cent of the sales.

34 Q. For that year, then . . .

A. (Interposing) For the year 1952.

35 Q. For that year, then, the Revenue Service did recognize that 60 per cent of your mined product was fire clay?

A. Yes.

36 Q. Then for the years 1953 and '54 and '55, if you know, what was the theory on which the Internal Revenue Service computed your allowable depletion and your income taxes?

A. During those three years they computed depletion based on a fixed—what they claimed "market value" of the clay at $7.00 per ton, on which they allowed us 15 per cent on 60 per cent of the tonnage shipped, or tonnage produced, and 40 per cent on 5 per cent of the tonnage pro-

duced. That amount was reduced by taking the limitation of 50 per cent of the profit which they estimated we had [fol. 119] received on the clay up to the $7.00 a ton price; in other words, 50 per cent of the difference between what they calculated the cost was and $7.00 per ton.

37 Q. I believe in all of the years we have been talking about, the 50 per cent limitation provided by the statute applied in your particular case did it not?

A. I am not sure about '51 or '52; I do know it did—I think that it did, I am not sure, but I do know it did in the other subsequent years.

38 Q. As President of Cannelton Sewer Pipe Company, are you particularly interested in the financial aspects of the company and those things that go into whether you make a profit or stand a loss?

A. I am. That section of the business is directly under my jurisdiction.

39 Q. Is one of your prime considerations in operating costs the hauling expense that you have in getting the raw clay to your plant?

A. It is.

40 Q. Have you informed yourself throughout your tenure as President of the company, as to your costs of hauling?

A. We segregate each year the hauling costs as part of our mining costs.

41 Q. During 1951, when you were using your own mine, approximately a mile and one-half from the plant, what did you estimate, or, what was the ton-mile cost of getting your clay to the plant?

A. 9.3 cents per ton.

42 Q. Is that hauling cost fairly uniform through subsequent years, or not?

A. Yes; it has increased slightly in subsequent years.

43 Q. Based upon your own actual experience, what would be the hauling cost from Huntingburg to Cannelton of the clay?

[fol. 120] I would say from $2.50 per ton to $3.00 per ton.

44 Q. And from Brazil, Indiana, to Cannelton?

A. From $5.50 to $6.00 per ton.

45 Q. During 1951, or in any years subsequent thereto, would it have been economically feasible assuming you

could obtain a fire clay and shale of the exact type and mixture that you were taking from your own mine to have purchased clay in Huntingburg at a price of $3.25 per ton and hauled it to Cannelton?

A. It would not.

46 Q. Would it have been economically feasible for you to have mined clay in Huntingburg and hauled it to Cannelton?

A. It would not.

47 Q. Would those same answers apply to Brazil?

A. They would.

48 Q. Could you purchase fire clay in Brazil for $1.60 a ton and economically—and haul it to your plant in Cannelton and make a profit on the finished product?

A. We might make a very, very slight profit, but it would be so small, there would not be much return on the investment.

49 Q. There has been considerable discussion, Mr. Clemens, in this case regarding the quality of the underclay which was mined by your company from the mine you were using in 1951. What kind of clay was that, in your opinion?

A. That was a fire clay . . .

Mr. Friesen: (Interposing for Deft.) I object to the question and answer, and moved that it be stricken; that he not has shown himself qualified as an expert on the subject of clays.

Mr. Travis: (For Pltf.) Your Honor, he has been manufacturing this for 42 years. He has been connected with [fol. 121] that company for 42 years. I think that, in itself, being the highest executive officer, would of necessity require him to know what the products were they were using.

The Court: Well, I will overrule it. Proceed.

Mr. Travis: (For Pltf.) That was just a preliminary question to something else anyway.

50 Q. (By Mr. Travis) Has there been any other producer of clay products that used clay and shale out of the same vein that you were mining in 1951?

A. There was a producer who used it in previous years; not in 1951.

51 Q. Well, the same vein you were using in 1951?

A. Yes.

52 Q. Where did they take that from, whoever took it?

A. They took fire clay from a vein, approximately, from the same vein at a location approximately one and a half miles east, one to one and one-half miles east to the opening we had in 1951. It is in the same hill.

53 Q. In the same hill?

A. Yes.

54 Q. What company was that?

A. Cannelton Clay Products Company.

55 Q. What did they produce out of that clay?

A. Second quality fire brick.

56 Q. Fire brick?

A. Yes.

57 Q. Was that a refractory product?

A. Yes, it was.

58 Q. How long did that company produce fire brick out of that mine?

A. They went in busines in 1917 and quit about 1928.

59 Q. Mr. . . .

[fol. 122] Mr. Friesen: (Interposing for Deft.) Your Honor, I object to that line of questions and answers in that it shows no relationship to the Year 1951, and with the testimony that clay varies both laterally and vertically, it is somewhat remote to the problem before us.

The Court: Overruled.

Mr. Travis: (For Pltf.) I am through with that line of questioning, anyway.

60 Q. (By Mr. Travis) Mr. Clemens, is there any reason why you use fire clay in the manufacture of sewer pipe in Cannelton, Indiana?

A. There is.

61 Q. And what is that reason?

A. Fire clay is necessary to hold the product in shape by reason of its long vitrification range, enabling us to burn it to a steel hardness and thoroughly vitrify it over a long range of burning. If something of this nature is not used, with the shale that we were using, the material would have a tendency to go out of shape in the burning.

62 Q. You could not, from your testimony I take it,

have made a quality sewer pipe out of the shale alone?

A. No, sir. For a great many years, beginning in 1912, shortly after we started in business, our company promoted and advertised Cannelton pipe as sewer pipe of a quality made of Ohio River fire clay. That was our slogan. We attempted to live up to it; and the tests that were made by the various universities and State Highway Department indicated that we have a product which is extremely high in quality and in crushing strength. We have attempted to live up to it, that slogan, and make a high-quality products. Actually, we have a number of engineers *who* specifications read "Cannelton pipe or equivalent."

[fol. 123] 63 Q. By "Cannelton pipe" they mean the pipe manufactured by your company?

A. Yes, sir.

64 Q. Are you familiar with tests that have been run by the State Highway Commission? You said you were. Have they found from those tests that your pipe was the highest quality made in Indiana?

A. I don't know how their comparison would run, but since 1932 they have been testing our pipe for use in the State Highway Department and on State Roads. In all that time we have never had a piece of pipe to fail any of the tests, and I don't believe any other manufacturer in the State could make that statement.

The Court: By "State Highway Commission" you mean Indiana or Kentucky?

The Witness: Indiana State Highway Department tested it.

The Court: All right.

Mr. Friesen: (For Deft.) I object to that answer, and I am quite sure it involves hearsay, which we have no chance to cross-examine the men who were the ones that tested this from the State Highway Department, or to know exactly what tests are involved.

The Court: You have rebuttal. The objections are coming a little late. I advise you to get on your feet when these questions are asked. It is hard for me to wring that out of my mind.

Mr. Travis: (For Pltf.) Your Honor, it is already in the record in Dr. Murray's deposition which was unobjected to at the time.

65 Q. (By Mr. Travis) Mr. Clemens, the change in the Internal Revenue Code, which allowed percentage depletion for clay for the first time went into effect January 1, 1951. You are familiar with that?

A. Yes, sir.

[fol. 124] 66 Q. Did you change any of your methods down there in the way of mining or selling or manufacturing solely on account of the change in the Internal Revenue Code?

A. No, sir.

67 Q. And until you started negotiating—getting clay in Kentucky instead of Indiana, your entire business went along just the same, before and after?

A. Yes, sir.

68 Q. (Cont'g) . . . the change in the Revenue Code.

A. Yes.

69 Q. Does your company maintain a permanent research department?

A. We do. We are the only manufacturer in this area that does.

70. Q. What do you do in that?

A. We are continually testing raw materials, testing our schedules, trying to develop new products and doing our —the men in there help on the clay prospecting. It is a general range both controlled and research laboratory.

71 Q. Over the years have you invested and spent quite a bit of money in that research program?

A. We have.

72 Q. How many industrial plants are there in Cannelton today?

A. Well, we have our plant there, and there is another small plant, the Mid-West Safe Company, who employs a few people; other than that, there is no industry.

73 Q. Your company is substantially the whole industry of Cannelton, isn't that true?

A. Yes, sir.

74 Q. There has been a reference made to the fact that at one time there possibly was some clay mined in Huntingburg which was hauled and manufactured into products [fol. 125] at Louisville. Are you familiar with that at all?

A. Yes, sir. There was a sewer pipe mined in Louisville a number of years ago who, I think, got some clay, I think

they got some clay from Huntingburg, or just west of there, and shipped it into Louisville.

75 Q. There was another company that made stoneware, that did that, is there?

Mr. Friesen: (For Deft.) Mr. Travis, are you testifying?

Mr. Travis: (For Pltf.) I was asking what we all knew and I forgot.

76 Q. Is the cost of raw clay for making your products and those for making stoneware products different? That is, in comparison of the sale of the finished product.

A. The percentage of the sales' part of the finished product that is brought about by the raw clay is much greater on sewer pipe than it would be on stoneware.

77 Q. So that the cost of the clay is a bigger factor to you?

A. Yes, much larger factor.

78 Q. Now, in regard to this clay that you are now getting from Kentucky, and which you have contracted for the mining and hauling, is the fact it is in Kentucky of any significance to you?

A. Well, I don't know what you mean exactly.

79 Q. Well, might you have done it if it was in Indiana as well as Kentucky?

A. Yes, we were—As a matter of fact we began prospecting for a strip mine deposit in 1950, and we tested clays all over the area immediately around Cannelton, in preference to going across the river. In going across the river, we would find that it is necessary to have an extremely large storage shed, because of the delays which come in [fol. 126] the wintertime, due to high waters which put the ferry out of commission, and due to the ice which occasionally gets in the river—did this year; stopped the ferry traffic. For that reason we exhausted our efforts to find a suitable clay in Perry County and Spencer County just before going to Hawesville and making tests on large scale.

80 Q. Did you ever open a strip mine in Indiana?

A. We opened a strip mine about 11 miles from Cannelton in Spencer County, known as King Mine, and we bought several hundred tons. We contracted with a local contractor who had digging and stripping equipment to bring the clay into us, and he brought it in and we tested it, but we rejected it because it was not suitable for our purpose.

81 Q. You could not go ahead with that mine?
A. No, sir. It is still overcovered there.
82 Q. But the mining and hauling, let me understand you, of that particular opening was done by an independent contractor rather than you?
A. Yes, sir.

Mr. Travis: (For Pltf.) That's all.
The Court: Cross-examine.

Cross-examination.

Questions by Mr. Friesen:

83 Q. Mr. Clemens, I hand you what appears to be an income tax return for the Year 1951, fiscal year ending November 30, 1951, and ask you if you recognize that.
A. I do.
84 Q. Do you know if that is the return which your company originally filed?
A. So far as I know it is. There was an amended return [fol. 127] filed and I don't know, but I assume this is the original one.
85 Q. And does that show any deduction for depletion?
A. That I would have to find.
86 Q. I believe it would be on the front page, the line which shows "Depletion," line 26.
A. It shows no deduction on the report.
87 Q. And this was filed February 11, 1952?
A. Yes, sir.
88 Q. Now, at the top of the page, in line 2, "Cost of Goods Sold" shows $880,649.18, and "Other deductions authorized by law" appears to be $443,030.39. How do you differentiate these two deductions in terms of what they stand for?
A. I will have to look at the individual schedules, which were prepared by our accountants. (Examining return.) I used to make these out myself but they got too complicated.
89 Q. The $880,000 figure is the cost of goods sold, isn't it, Mr. Clemens?
A. I assume it is.
90 Q. Would you look on the front and see if you can verify your assumption?

A. Yes, sir.

91 Q. Would that include the cost of mining which Mr. Eugene Clemens has reported at $93,000?

A. Yes, sir.

92 Q. And when I asked Mr. Eugene Clemens if there was any overhead included in the cost of mining, I believe his answer was it did not appear from the schedule.

A. No, sir.

93 Q. The 443,000 taken from Schedule K, or part of which is taken from Schedule K, a part of which is listed on the face of the return, are other expenses which were [fol. 128] deductible, were they not?

A. Yes, sir.

94 Q. Would you call those generally overhead expenses?

A. Administrative, selling and so on.

95 Q. None of those expenses were allocated to the cost of mining clay, $93,000, approximately 10 per cent of the $880,000 figure for cost of goods sold; so, that would indicate that about 10 per cent of the cost of goods sold was the cost of mining. Shouldn't 10 per cent of the overhead, administrative expenses, also be attributed to mining?

A. No, sir.

96 Q. Why shouldn't it?

A. There are certain overhead expenses included in that $93,000 figure. Practically all of the overhead, with the exception of a portion of salaries of executive salaries, is included in that particular item.

97 Q. Well, now, did you ever have any labor problems involving necessity of counsel in connection with your mine?

A. No, sir.

98 Q. Do you ever have to have legal advice on the leases in connection with your operations?

A. Small amount.

99 Q. Wouldn't part of the legal expenses be attributable as well as the officers' salaries?

A. Nominal sum, possibly a Hundred Dollars or Two.

100 Q. Isn't it a fact this mining operation is an essential part of your total operation?

A. Yes, sir.

101 Q. Wouldn't it be just as logical to prorate your administrative and overhead expenses to the cost of mining, as it is to prorate them to any other part of your operation?

[fol. 129] A. We are comparing our mine costs with what we might have to pay if we purchased. If we cut off this mining operation completely and purchased all of our clay, we would not reduce our overhead any.

102 Q. You would agree if the overhead and administrative expenses were prorated, an essential part of your production, that that figure of 10 per cent which is the proration of the costs could increase the cost per ton by some 40 cents a ton, or more, wouldn't it? I am sorry—by 80 cents a ton or more.

A. I don't get that.

103 Q. Well, if you take 10 per cent of the $443,000, it would be some $43,000. If you added that to the cost of producing, mining, it would come to some Hundred and Thirty Thousand Dollars which, divided by your 38,000 tons of material, would raise the cost to some Three Dollars and Sixty Cents.

A. If it were added, it would, yes.

104 Q. You have indicated that the Revenue Service has used several different theories in computing your tax. Have you ever known the Revenue Service to make a mistake?

A. I hope they have in this instance.

105 Q. Have you ever made a mistake in referring to the Revenue Service your opinions and beliefs on this percentage depletion?

A. Have we made a mistake?

106 Q. Yes.

A. We filed our original return, based on a different theory, which was denied.

107 Q. And you made a protest, did you not, at one time to the Internal Revenue Service after a 30-day letter was issued?

A. Yes.

(The defendant, for purposes of identification handed the reporter a document, consisting of four pages, for mark-[fol. 130] ing and which was by said reporter marked the Government's Exhibit F.)

108 Q. (By Mr. Friesen) I hand, Mr. Clemens, what has been marked for identification the Government's Exhibit F, and ask you if it is your signature appearing on the last page.

A. It is.

109 Q. Did you not state on page 2, of this document having four pages, "that in preparing our amended returns for the years involved and the claims for refund and abatement, we used as a basis for calculating the gross income from our mining operations of shale and fire clay the point in our manufacturing operations at which we first arrive with a commercially marketable product, which is ground fire clay. This product arrives after the raw mineral is crushed and granulated to such extent that by the addition of water it can be made into a mortar for use in laying or setting fire or refractory brick. This ground fire clay has a definite market and an ascertainable market value at any particular time and is the same product from which our end product, sewer tile, is made simply by the addition of water and the necessary baking process."

A. We made that statement, yes, sir.

110 Q. Do you now believe it to be true and accurate?

A. Based on the theory the statement was made, I do not now believe that is correct, because the Courts have held otherwise. In that particular case we based that on the value of the sales, value we received; namely, $22.00 per ton, or whatever the exact amount was, on the amount of clay to be sold.

Mr. Friesen: (For Deft.) I now offer the Government's Exhibit F into evidence.

(Government's Exhibit F was offered in evidence at this time by Mr. Friesen.)

[fol. 131] Mr. Travis: (For Pltf.) No objection.

The Court: F is admitted, read and exhibited in evidence.

(Government's Exhibit F, consisting of four pages is admitted into the evidence, and made a part of the record in this case, said exhibit being in the words and figures following, to-wit:)

(Here Insert.)

111 Q. (By Mr. Friesen) Mr. Clemens, can you compete with the American Vitrified Products Company in the Chicago market on the sale of sewer pipe?

A. We do up to a certain stage, yes.

112 Q. Does that involve transporting sewer pipe from Cannelton, Indiana, to Chicago, Illinois?

A. Yes, sir.

113 Q. And how are you able to compete if the transportation costs would make your operations unprofitable?

A. For one thing, the American Vitrified Products Company has a higher f.o.b. plant basis then we have at Cannelton; due to the Southern competition we encounter, we have lower f.o.b. plant base. When we come into the Chicago market, we have to absorb a small amount of freight based on current prices to be competitive with them. They have the same situation if they attempt to compete with us in our trade area near our plant; and as the result, in most of the area they do not attempt to compete.

114 Q. Now, then, the testimony indicates that the transportation costs from Cannelton to Brazil is $4.40 cents a ton. Am I to understand that you absorb that freight rate when you are competing in Chicago?

Mr. Travis: (For Pltf.) Just a minute. The plaintiff objects to the question. There has been no freight rates [fol. 132] introduced on finished products that I am aware of.

Mr. Friesen: (For Deft.) The testimony has been, as I recall, the freight rate would be higher on the finished product, so I was taking the lower figure.

Mr. Travis: (For Pltf.) I repeat: There was no figure given for trucking freight or any other way.

The Court: I have no recollection. I recall you . . .

Mr. Friesen: (Interposing for Deft.) No, your Honor, not on the finished product, but I believe Mr. Clemens testified that the rate would be higher for shipping the finished product than for shipping the crude clay.

Mr. Travis: (For Pltf.) They don't ship by rail freight, in the first place, their finished product.

The Court: As I recall your questioning of Mr. Eugene Clemens on that subject was the cost of handling the finished product more than hauling of clay, and he said, no, it would be about the same, and you brought in the subject of the Chicago market "while you don't ship clay, you ship the finished product"; but you never got into the amount.

Mr. Friesen: (For Deft.) I withdraw my question.

The Court: That is my memory and I stand corrected . . .

115 Q. (Mr. Friesen interposing) Do I understand you absorb the cost of shipping the finished product by truck from Cannelton to Brazil, then, Mr. Clemens?

A. We absorb a part of the costs in that the factory basis that American Vitrified Products Company normally uses in that area, which is pretty much the determining factor on the delivered price, is somewhat higher than our factory basis. So, we take our factory basis, plus our actual trucking cost up there; we absorb a small amount.

[fol. 133] 116 Q. This would be true in a case where there is a producer of sewer pipe between your operation and your market area, isn't that correct?

A. That's correct.

117 Q. So the relative cost or ability to produce from a given clay, a certain product, assuming the clay is of the same kind, would depend also upon where your market for the same of the finished product is, wouldn't it?

A. If I understand you correctly, yes.

118 Q. Mr. Clemens, I believe you told me that you purchased some fire brick from the Huntinburg Brick Company?

A. We have, yes, sir.

119 Q. Referring to these tests which you stated you had run by the State Highway Department, did they ever run a test to determine whether your product consisted of fire clay?

A. No, sir.

120 Q. Did they ever run a test to determine whether your product was refractory?

A. No, sir.

121 Q. The test they run is simply the matter of showing the strength of the material?

A. Crushing strength and absorption.

122 Q. Run a freeze and thaw test?

A. No.

123 Q. They do not. So, the tests they run have nothing to do with whether or not you put fire clay in your product?

A. They do not.

Mr. Friesen: (For Deft.) I have no further questions.

[fol. 134] Redirect examination.

Questions by Mr. Travis:

124 Q. Mr. Clemens, it has been shown on your cross-examination that your company for the fiscal year ended November 30, 1951, used several theories in computing its deduction for depletion. Now, just what was the reason for that?

A. When the law was first passed, I happened to be a member of the depletion committee, of the National Clay Pipe Manufacturers, Inc. We were quite anxious to find out what was the proper theory on which to file our returns. As a member of that committee, I went to Washington and at that time was in a conference with Mr. Williams and Mr. McGinnis, of the Revenue Department. I asked them point-blank what basis should be used for computing the sales' value . . .

Mr. Friesen: (For Deft.) I object, your Honor, on the ground on what he is going to testify to would be hearsay.

Mr. Travis: (For Pltf.) It is with your agent.

Mr. Friesen: (For Deft.) I know Mr. Williams very well, and his theories, and I don't think we should have him quoted without a chance to state also what his views are.

The Court: Who is Mr. Williams? An agent of the Government?

Mr. Friesen: (For Deft.) Chief of the Natural Resources Section, of the National Office of the Internal Revenue Service. He has no rule-making power, or anything, other than advisory capacity, and I might add, is often disagreed with by those who do make rules.

Mr. Travis: (For Pltf.) The only purpose this will show, your Honor, is no one, including the top resources men, in the Internal Revenue Service knew what basis to use, and [fol. 135] the matter had not been settled until October, 1957, by the Supreme Court of the United States.

Mr. Friesen: (For Deft.) As to brick and tile clay, where there was no market, I will agree; but as to this case, I think it is first impression, and the fact should divide and not bring the mistakes made in the past.

The Court: We might as well make it good and confusing, and let the evidence go in. Finish your answer.

A. (Cont'g) At that time in an informal way—there was no formal ruling requested of any kind—I told them we had sales of a certain amount of ground fire clay in with our general sales; that I did not know the amount; and I said "How would you go about filing your return under the circumstances?" They said, "Well, just go ahead and file it on the basis of taking the price you got for ground fire clay, and make it applicable to the entire production." They made it very plain it was not official; an official rule and regulation would be issued afterwards. Immediately after, the bill was passed and before anybody had a chance to make up their mind.

125 Q. (By Mr. Travis) At the time your company filed its protest, which Mr. Friesen read from, would you have been willing to settle your depletion question for the fiscal year ending November 30, 1951, with the Revenue Service on that basis?

A. We would have.

126 Q. And did the Revenue Service agree with you?

A. No, sir.

Mr. Travis: (For Pltf.) That's all.

Recross-examination.

Questions By Mr. Friesen:

127 Q. Referring back to the Revenue Services's theory that has been advanced, you stated that during a couple [fol. 136] of the years they had computed your gross income from mining on the basis of the cost of the processes up through the grinding and screening. Is that correct?

A. That is correct.

128 Q. They also added to that a proportion of profits?

A. That is correct.

129 Q. Which you have not stated previously.

A. Well, I should have; I'm sorry.

130 Q. And that proportion of profits was computed on the basis of your total profit from the entire operation, was it not?

A. Yes, the relative percentage of the profit was the ground clay cost was of the total profit

131 Q. Do you know if that was in keeping with the regulation of the Internal Revenue Service then in effect?

A. That was in keeping with their regulation at that time.

Mr. Friesen: (For Defts) I have no further questions.

Mr. Travis: (For Pltf.) Step down.

(Witness Excused.)

The Court: Call your next witness.

Mr. Travis: (For Pltf.) If your Honor please, the plaintiff has no more witnesses at this time except the deposition. Does your Honor wish it read in evidence?

The Court: Are there any objections? I believe it should be read.

Mr. Friesen: (For Deft.) I think all of them are made in the body of the deposition.

The Court: The Court will have to rule.

Mr. Travis: (For Pltf.) Mr. Friesen and I have discovered quite a number of typographical mistakes and [fol. 137] with the Court's permission—some of them are quite vital—we would like to have the reporter change the deposition in pen as we agree.

The Court: Before I forget, you indicated this is a case of first impression. Are there any other cases pending?

Mr. Friesen: (For Deft.) There is one in Birmingham, Alabama, which has not been tried and is not now set for trial. There is one—There are four or five which have gone through the pleadings stage in both the Northern and Southern Districts of Ohio. There is a ruling in the case on coking coal, by Judge Lynn in the Northern District of Alabama.

The Court: That is not the Birmingham case?

Mr. Friesen: (For Deft.) No. It is a coking coal case. These are all clay cases. Alabama By-Products against the United States is on appeal to the Fifth Circuit by the taxpayer.

The Court: Did the lower court write an opinion?

Mr. Friesen: (For Deft.) Findings of fact and conclusions of law were filed.

Mr. Travis: (For Pltf.) I think in that connection it would be well for the Court to know in Louisiville, the Court sitting in Louisville, since the Supreme Court de-

cision, and you might say our trading area, Cannelton, the Murray Brick and Tile have prevailed over the Government in their case.

The Court: Are you familiar with that?

Mr. Friesen: (For Deft.) It was on the theory, conceded by the Government, there was no market which may have been erroneous, and in my opinion there have been many concessions by the Government along this line, where there was an actual market based on the policy of the Revenue Service at the time; in this connection I might say investigations of markets in the past have run across [fol. 138] the difficulties which ran across here in finding a well concealed market by leasing and mining arrangements, so that many times we honestly believed there was no market where we might today have been able to prove one.

The Court: All right.

Mr. Travis: (For Pltf.) In the Murray case, the Government filed Notice of Appeal, and later withdrew.

Mr. Friesen: (For Deft.) Which we have done in many cases. We have conceded without even going to trial.

Mr. Travis: (For Pltf.) Do you want to omit the formal introductory part? (Referring to deposition of Dr. Haydn H. Murray).

Mr. Friesen: (For Deft.) The Government agrees to that.

(At this time the deposition of Dr. Haydn H. Murray was read into the record by counsel for plaintiff and counsel for defendant, said deposition, as read, being in the words and figures following, to-wit:)

"Haydn H. Murray, being first duly sworn to testify the truth, the whole truth, and nothing but the truth, relating to said cause, deposes and says:

Direct examination.

Questions By Howard P. Travis:

1 Q. State your name.
A. Haydn H. Murray.
2 Q. Where do you live?

A. Berkeley Heights, New Jersey.

3 Q. What is your business, Dr. Murray?

A. I am the Director of Applied Research for the Georgia Kaolin Company, Elizabeth, New Jersey.

4 Q. What would you call yourself as a scientist?

A. Clay mineralogist.

[fol. 139] 5 Q. Where were you educated, Doctor?

A. I was educated at the University of Illinois.

6 Q. What degrees did you receive there?

A. Bachelor of Science, Master of Science and Ph.D.

7 Q. When did you get your Doctor of Philosophy degree?

A. 1951.

8 Q. What subject did you major in, if any, at the University of Illinois?

A. I majored in clay mineralogy and minored in mining engineering.

9 Q. What work did you do after you graduated from the University?

A. My first job was as clay mineralogist with the Indiana Geological Survey and associate professor of geology at Indiana University. I left that job last year in February to become the Director of Applied Research with the Georgia Kaolin Company.

10 Q. What engineering societies are you a member of?

A. American Ceramic Society, American Institute of Mining Engineers and the Association of Petroleum Geologists.

11 Q. When you were with the Indiana Geological Survey, from 1950 to 1957, what sort of work did you do?

A. The Indiana Geological Survey in 1950 set up a program to study all of the clay resources in the State of Indiana. I was in charge of that program and visited every ceramic plant in the State of Indiana and sampled all formations that might possibly have a utilization of clay or shale.

12 Q. Have you written articles and prepared maps and other data as a result of your studies?

A. Yes.

13 Q. What is the Indiana Geological Survey?

[fol. 140] A. It is an organization that is a part of Indiana University, controlled by Indiana University to study the natural resources of the State of Indiana.

14 Q. It is really a State organization, isn't it?

A. Part of the State government, yes. The funds come from the Department of Conservation.

15 Q. Yes. So, you are familiar with all of the clay formations and with the products produced from those clays in the State of Indiana?

A. Yes, sir.

16 Q. For all of those years. I will hand you what the reporter has identified as Plaintiff's Exhibit No. 1 and ask you what that is.

A. This is a map showing the location of the clay and shale pits and ceramic plants in Indiana. This work was accomplished by me in 1952.

17 Q. And the "H. H. Murray" in the lower right corner is you, is that right?

A. Yes, sir.

18 Q. The things shown on this map were in existence during 1951, were they?

A. Yes, sir.

19 Q. I will hand you what the reporter has identified as Plaintiff's Exhibit 2, and ask you what that is.

A. This is a map of southwestern Indiana, showing the general out-crop area of the Pennsylvanian bed rock in the State of Indiana.

20 Q. And if you will look at what has been identified as Plaintiff's Exhibit 3, and state what that is.

A. This is a generalized stratigraphic column of Pennsylvanian formations of Allegheny and Pottsville age in west-central Indiana.

21 Q. Where did those pages come from?

A. These pages are Figures 1 and 2 from the Report of Progress No. 11 entitled PENNSYLVANIAN UNDERCLAYS-Po-
[fol. 141] TENTIAL BONDING CLAYS FOR USE IN FOUNDRIES by myself, which was published in 1957.

22 Q. Was that in connection with your work for the Geological Survey?

A. Yes, sir.

23 Q. And it was published by them, I suppose.

A. Yes, sir.

24 Q. Are you familiar with the operations of the Cannelton Sewer Pipe Company in the years while you were connected with the survey?

A. Yes, sir.

25 Q. You have been through their plant.

A. Yes, sir.

26 Q. Are you familiar with the clay that they were mining in the years 1951 and 1952?

A. Yes.

27 Q. Have you had samples of those clays in your possession?

A. Yes, sir.

28Q. And have you run tests on those clays?

A. Yes, sir.

29 Q. Where was that mine that Cannelton was using in 1951?

A. Do you want the exact location?

30 Q. No; approximately.

A. The mine that they were operating in 1951 was south of Highway 237, just a little bit north and east of Cannelton.

31 Q. Within a mile or so of their plant, is that true?

A. Yes, sir.

32 Q. You were in that mine, were you?

A. Yes, sir.

33 Q. What were they taking from that mine?

A. They were taking a fire clay and a shale from beneath [fol. 142] the coal seam which was called the Cannelton Coal.

34 Q. Is that a part of the Pennsylvanian formations that you have testified about?

A. Yes, sir.

35 Q. And is shiwn on that map?

A. Yes, sir. It is the lowest coal formation in Indiana.

36 Q. That particular point, you mean, where they were mining?

A. Yes, sir.

37 Q. Is there any significance attached to that?

A. Well, in a general way, taking the Pennsylvanian rocks as a whole in the United States, the clays that occur beneath coals which are oldest in the Pennsylvanian system, are more refractory. Now, this is a general statement, but it holds true in Pennsylvania, Ohio, Indiana, Illinois, Missouri and states where most of the refractories are made. We number the coals in Indiana from coal No. 1 through coal No. 8 as our commercial coals; and the most refractory clays occur below coal No. 3. Coal No. 3, which means that the oldest clays are the most refractory.

38 Q. Then would you classify this clay that Cannelton was using as one of the older clays appearing in Indiana?

A. It is the oldest clay that is mined in Indiana, the oldest fire clay that is mined.

39 Q. Now, if you will look at Plaintiff's Exhibit No. 2, state whether or not there are any fire refractory type clays in Indiana other than the Pennsylvanian formations that is shown on that map.

A. There are no refractory clays in Indiana other than those found in the Pennsylvanian rocks in Indiana.

40 Q. Are there any clays in Indiana suitable for making [fol. 143] the type of sewer pipe made by the Cannelton Sewer Pipe Company other than those in the Pennsylvanian formations?

A. No, sir.

41 Q. I will hand you what has been identified as Plaintiff's Exhibits Nos. 4, through 10, inclusive, and ask you to state what those are in their order.

A. Exhibit 4 is a summary of the ceramic tests and sample descriptions of the clay used by the Cannelton Sewer Pipe Company, and this is a summary made by Jack Harrison of the data that I did when I was with the Indiana Geological Survey. Jack Harrison is now the Clay Mineralogist for the Indiana Geological Survey.

42 Q. When was that data accumulated?

A. The samples were accumulated in 1950 as evidenced by the "M" which stands for "Murray." The "50" is for the year, and the "27" is the sample number.

43 Q. Is that the same clay Cannelton Sewer Pipe Company was mining in 1951?

A. Yes.

44 Q. All right, go ahead with the next one.

A. Exhibit 5 is a letter of Mr. Eugene Clemens from me in April, of 1955, giving him a mineralogical analysis of the clay that was being used in the plant.

45 Q. All right.

A. Exhibit 6 is another letter to Mr. Clemens from me in April, of 1955, giving a mineralogical analysis of the shale which occurred below the fire clay in his mine.

Exhibits 7 through 10 are data sheets prepared at the Indiana Geological Survey summarizing the physical tests and mineralogy of samples M5027 and M5030.

46 Q. On the analysis of the clay which was mined what were the P.C.E. numbers on those tests you ran?

[fol. 144] A. The fire clay 5027 was Cone 20. Fire clay sample M5028 was Cone 23. The shale that occurred below the fire clay M5029 was Cone 10. And 5030, also a sample of shale taken at a different location, was Cone 19.

47 Q. On the sheets that you now have in your hand, which are Exhibits 7 through 10, there are notations in pencil on the bottom. Whose handwriting is that, or who made those notations?

A. That is my writing.

48 Q. When was that written on there?

A. This was in 1955. During the Summer of 1955 I revisited every ceramic plant in the State, taking data sheets along with specimens of the shales that I collected in the Summers of 1950 and '51 to show the ceramic people in the State the results of our test on their raw materials.

49 Q. And your handwriting on there was put on there prior to your delivering those to the Cannelton Sewer Pipe Company?

A. I delivered these to Mr. Clemens in his office, and he asked me some questions about them, and I wrote this on there at the time I give it to him.

50 Q. I will hand you what has been identified as Plaintiff's Exhibit No. 11, and ask you what that is.

A. That is a sample of the briquette that we used for testing the fire clay samples that we got from Cannelton Sewer Pipe in 1950. We made up a series of these which we made all these tests on, and this is one example that we took to the plants.

51 Q. And do the figures stamped on those briquettes have have any significance in relation to the analyses that you reported to the Cannelton Sewer Pipe Company?

A. The No. 5027 identifies the sample corresponding to the 5027 on the data sheet.

[fol. 145] 52 Q. And the same information is applicable concerning Exhibit 12, which is 5028?

A. Yes.

53 Q. Are those actually fired samples of the clay distinguished from shale, mined by Cannelton Sewer Pipe in 1951?"

Mr. Travis: (For Pltf.) May we strike out the word "mined" (referring to original deposition) as it is a duplication and is rep-titious?

Mr. Friesen. (For Deft.) Yes.

The Court: I tell you, suppose we have a few minutes' recess and maybe you can make the corrections. I think our reporter needs a little break at this time.

(Whereupon the Court was recessed at 10:50 a.m., and reconvened at 11:22 a.m., at which time the following proceedings were had:)

Mr. Travis: (For Pltf.) Your Honor, both caunsel have agreed, unless the Court wants it read otherwise, we will waive the reporter taking it down.

The Court: All right.

Mr. Friesen: (Fof Deft.) If there is any argument on a particular ruling, we can have it inserted.

The Court: I leave it to you to call it to the attention of the reporter, so we will have it all.

"53 Q. Are those actually fired samples of the clay distinguished from shale mined by Cannelton Sewer Pipe in 1951?

A. Yes.

54 Q. What was the purpose of the test that you ran that resulted in those particular briquettes?

A. The purpose of these tests was to establish the type of raw materials that were being used for ceramic production in the State of Indiana so that we would have some standards with which to compare the raw materials that we might collect in later years to see how they com- [fol. 146] pared with those that were being used at the present time.

55 Q. From the exhibits which have been just identified, including your analyses, what would you describe that clay as, that particular clay that Cannelton Sewer Pipe was mining?

A. The general term that describes the clays of the Pennsylvanian system is underclay. This is a genetic term which means that it is any clay that is found beneath a coal bed, meaning under the coal, clay designating the type of rock that is found under the coal. So underclay

is a general term that has no economic connotation. Fire clay does have an economic connotation. It refers to material that fires to a non-white color, is high in aluminum silicate, has a kaolinite content, and is refractory. The material that Cannelton was mining in 1951 was definitely a refractory clay.

56 Q. Fire clay?

A. So it would be called a fire clay.

57 Q. In your travels through these mines and plants located throughout southwestern Indiana, and your conversations with producers of various ceramic production, did you also familiarize yourself somewhat with the economic situation in regard to the use of clays for actual production?

A. Yes, sir.

58 Q. Considering the locations of the plant of Cannelton Sewer Pipe Company, would it have been economically feasible for them to have purchased clay other than within a very short radius of the city of Cannelton and to be used in their production?

A. No, sir. Most structural clay production is a relatively low-priced commodity and, therefore, the cost of the raw material has to be very low. The clay that can be used for sewer pipe in the State of Indiana is all in the western and southwestern part of the State. The [fol. 147] nearest sewer pipe plant to Cannelton in the State of Indiana is at Brazil, Indiana, and it is not economical to ship further than approximately, oh, I would say, 20 to 30 miles to make a product of this type.

59 Q. Are there any other plants in the extreme portion of southern Indiana that are making vitrified products?

A. None that are making sewer pipe, no.

60 Q. Where is the nearest plant to Cannelton using your map if you wish as a guide, which uses and must use fire clay?

A. The nearest plant that must use fire clay for one of their products is Huntingburg.

61 Q. What product is that?

A. They make a low-duty fire brick. This was in 1951. I can not speak for the present.

62 Q. Yes, that is what we are talking about.

Now, would it have been economically feasible, in your opinion, for the Cannelton Sewer Pipe Company to have purchased clay in Huntingburg and haul it to Cannelton?

A. No, sir. The distance would be too great. It was underground mining so the cost of mining would also be prohibitive.

63 Q. Assuming they could have purchased fire clay in Huntingburg at $3.25 per ton, would it have been economically feasible for them to have purchased that fire clay in Huntingburg and hauled it to Cannelton?

A. This would be my opinion, but I would say no.

64 Q. Then how about Brazil? Would it have been economically feasible for them to have purchased fire clay in Brazil and hauled it *to* Cannelton?

A. Definitely not.

65 Q. Do you have any knowledge of any sales of fire clay in the extreme southwestern portion of Indiana?

[fol. 148] A. Huntingburg Brick Company bought fire clay from the Uhl Pottery Company which is now Louisville Pottery, I believe—I am not sure of the year, in 1951 or 1952, though, they bought a little bit because they were running into trouble in their own mine. The Uhl Pottery was also located in Huntingburg. That is the only fire clay that was sold in Indiana, to my knowledge, in that southern part of the State. That excludes the Brazil area, of course.

66 Q. Yes. Are you also familiar with the plants using clay which are in the immediate vicinity of Cannelton and across the river in Kentucky?

A. Yes, to some degree.

67 Q. Is that the same Pennsylvanian formation that has some out-croppings in Kentucky, too?

A. Well, the same out croppings are across the river at Hawesville, but the clays that are being mined at the present time in Kentucky are of a younger age than those mined by the Cannelton Sewer Pipe Company in 1951. They are not the same formations.

68 Q. Can any clay be made into sewer pipe?

A. No, sir.

69 Q. Is there considerable testing and research necessary on various clays before it can be determined whether it is suitable for making sewer pipe?

A. Yes. To make a good sewer-pipe product, you have to have a mixture that will mature at the correct temperature of firing. You have to have the right plasticity conditions, shrinkage conditions and a different research project has to be set up for each size. There are different problems concerned with making a small size pipe, from, say, an 18 or 24-inch pipe. So, there is considerable research and study that has to be done before you can put a clay into production.

70 Q. Just to get it in the record, P.C.E. means "pyrometric cone equivalent," does it not?

[fol. 149] A. That is right.

71 Q. What does that mean?

A. That is a set of standards that is used by the A.S.T.M. to determine the maturing or fusion temperatures of a clay body. These cones are made up with different mineral constituents, and they will melt at certain prescribed or definite temperatures which are standardized, and the higher the cone number, the higher refractoriness of the cone.

72 Q. What would be your own personal definition of a fire clay in relation to P.C.E requirements?

Mr. Friesen: I object to this question on the grounds that this gentleman's personal definition has no relationship to the case concerning the generally understood commercial meaning of the term which relates to our problem."

Mr. Friesen: (For Pltf.) I withdraw the objection on the basis of the answer that was given.

The Court: Show the objection overruled. You may answer.

73 Q. Go ahead and answer.

A. The definition of a fire clay taken from Norton Refractories Book, Second Edition, in 1949, is that a fire clay is a material that will withstand temperatures above Cone 19. Now, there are other definitions that you will find in ceramic text books and the latest one I can cite is a recent publication by the Bureau of Mines in California where they used 2600 Fahrenheit as the refractory temperature. Now, this would be about Cone 15. So, there are some discrepancies in the exact cone

value in regard to what is a refractory material. But it is on the order of 2600 Fahrenheit and above. Cone 19 is 2740° Fahrenheit.

74 Q. And the clays which Cannelton Sewer Pipe was using in 1951, and which you analyzed, would qualify [fol. 150] as a fire clay under any of the definitions you have just referred to, would it not?

A. Yes.

75 Q. I will hand you what I would call a piece of rock and ask you what that is.

A. That is a piece of shale as shown by its laminated character. That is all you can say about it. It is shale.

76 Q. That is a piece of shale?

A. Yes, sir.

77 Q. What is this second one that I am handing to you?

A. This is an underclay, as shown by the texture. It has no laminated character, and also by the fact that it has these little rootlets or organic remains that extend down into the clay, this is what we call an underclay.

78 Q. You can not tell by looking at that piece of underclay whether you would call it a fire clay or not, can you?

A. No, sir. The only way you could tell, you would have to know something about the geology, the formation from which it was taken and the location. That is a matter of experience. You can't tell just by looking.

79 Q. If I told you that piece you are holding came from the mine which Cannelton was operating in 1951, could you then, knowing the geological formations, say whether it is a fire clay or not?

A. If I knew that it came from below the Cannelton coal in Indiana, I could say that it was a fire clay.

Mr. Travis: That is all.

Mr. Friesen: Mr. Travis, are you offering these exhibits that you havve numbered and identified?

Mr. Travis: Oh, yes, I will.

Mr. Friesen: I object to the admission of any and all of these in evidence until and unless it is established that they relate to the year 1951. As I recall, the tests were [fol. 151] all made from 1950, and some of them were made in 1955. If it is determined that those years are

relevant in determining the quality aspects of the material used in this case, then I will withdraw my objection.

Mr. Travis: Well, I thought that I had that cleared up as we went along, but let me ask one blanket question.

80 Q. The exhibits, Dr. Murray, that have been marked and which are analyses or letters written by you concerning the Cannelton clay, were those analyses made from samples similar to the clay being mined by Cannelton Sewer Pipe in 1951?

A. Yes, sir. The samples numbered M5027 through M5030 were collected by me personally from the mine of the Cannelton Sewer Pipe Company. We collected, during the Summer of 1950, a total of approximately 250 samples so that physical tests and mineralogical tests that were made on these samples took approximately three years to complete. Thesefore, the data that was accumulated on the samples that were collected during this period, some was done in 1953, and finished in 195[illegible]

Mr. Friesen: When were the samples collected? All of them were collected in 1950, weren't they?

The Witness: The particular ones at Cannelton were collected in 1950.

Mr. Friesen: So that any of the data that you arrived at in the next three years, referred to samples collected in 1950?

The Witness: In the Cannelton area, yes.

Mr. Travis: Plaintiff now offers in evidence Plaintiff's Exhibits 1 through 12, inclusive.

The Court: Any objection?

Mr. Friesen: (For Deft.) I renew my objection, your Honor. The relevancy of tests taken in 1950 and 1956 to [fol. 152] the problem, the Government would assert that, like a market, the quality of the clay may vary slightly over the years, and that information relative to a market as well as information relative to the type of clays in 1950, or 1952, or '3 would also be admissible and relevant; and I made by objection so as to preserve the point that I am making with reference to other data.

The Court: As I recall we have evidence in the record from the two Clemens that the product has remained consistent since its manufacture.

Mr. Travis: (For Pltf.) Until they closed the mine. As I understand, that is in the record. It is further brought out by Dr. Murray there is no significant difference in the clays from year to year taken from this mine.

The Court: Is it already in here?

Mr. Travis: (For Pltf.) No; part of the cross-examination.

The Court: I would overrule the objection. I think there is sufficient connecting evidence that the product is generally the same. So, show the admission into evidence of Exhibits 1 through 12, as admitted, read and exhibited in evidence.

(Plaintiff's Exhibits 1 through 12, inclusive, are admitted and read into the evidence, and made a part of the record in this case, said exhibits being in the words and figures following, to-wit:)

(Here Insert.)

"Mr. Travis: You may cross-examine.

Cross-examination.

Questions by Ernest C. Friesen, Jr.

81 Q. Dr. Murray, are clay deposits uniform in their constituence throughout the deposit?

A. No, sir.

[fol. 153] 82 Q. Will they vary in chemical content and physical structure of both laterally and vertically?

A. It depends on how far you want to extend that. The underclay, itself, will vary with depth. But over a distance of two to three feet below the coal, you will have pretty constant results.

83 Q. Then two or three feet below the coal, you will have pretty constant results?

A. Yes, sir. That is, in Indiana.

84 Q. If this clay, then, were six feet thick, not including any shale, then you might get a greater variation below the first three feet, is that correct?

A. It is possible. It, again, depends on the deposition. I have seen deposits that are essentially honiogeneous

as much as nine feet thick in Indiana. Others, I have seen them change in one foot.

85 Q. How many samples did you take at Cannelton in 1950 of the clay material?

A. You are excluding shale?

86 Q. Yes.

A. Two.

87 Q. You took two samples. How did you take those samples?

A. I took the samples on the basis of the lithologic character, that is, the character you could see, a difference visually.

88 Q. Did you use a particular method of taking your samples, such as channeling, or something like that?

A. I used a channeling method and channeled the sample on a piece of canvas and quartered the sample to get a representative sample of the material.

89 Q. Do you recall the height of the face from which you took the channel?

A. May I look at the sheet here?

90 Q. Certainly.

[fol. 154] A. Sample 5027 was a composite of the upper one foot of fire clay from the Cannelton mine.

91 Q. That tends to be more pure than the clays as they get deeper under the coal seam, is that correct?

A. You can't say that as a generalization.

92 Q. But it does occur that way, is that correct?

A. It can, or it does not necessarily.

93 Q. And the second sample, according to Plaintiff's Exhibit No. 2——

A. (Interposing) 5028 is the next four feet. In other words, it would be the interval from two feet to six feet below the coal.

94 Q. Those are the only two samples that you took out of the Cannelton clay on which you have made an analysis?

A. No, sir.

95 Q. What other samples did you personally take?

A. In 1952, I collected a 50-pound sample from the mine which was north of Highway 237 and used it in the Report of Progress No. 11 on Bonding Clays. And, then, in——

96 Q. (Interposing) Excuse me. That was from a different mine than the one you took in 1950, a different opening into the ground?

A. Yes, sir. In 1952, the Cannelton Sewer Pipe closed the mine I collected the original samples from. They had opened a new mine north of that locality. It was in the same formations and the characteristics of the clay were much the same. Then in 1955 or 1956, I don't remember the exact time, it was in the winter, Jack Harrison, the present Clay Mineralogist who was a student of mine, and I—at Indiana—collected additional samples at the Cannelton mine and made tests on them.

97 Q. Now, if between the time that you took that sample in 1950 and the beginning of the taxable year [fol. 155] that we have here in suit, they removed 30,000 tons of clay from the working face, would you expect to find a variation in testing of a sample?

A. In this particular type of geologic formations I would not expect a significant change in physical and mineralogical properties.

98 Q. What do you mean by a "significant change"?

A. I mean a radical change in shrinkage, in P.C.E. values.

99 Q. Would you refer to a change in kaolin content of five per cent, would you consider that to be a significant change?

A. No.

100 Q. Would the change in the free silicon content of two or three percent be a significant change?

A. No, not in this particular use. I might say that the underclays are more homogeneous in their use laterally than shales, for example. The characteristics of the geological conditions under which these materials were formed, make it such that underclays, in general, tend to be more homogeneous than the adjacent geologic formations, because it is an old soil and you are leaching the alkalies and the alkaline earth materials from the clay during weathering, so that they tend to be more homogeneous than shales, for example.

101 Q. Now, we have discussed significant differences between the clays in the time period that would elapse between the tax year and the time you took your samples. Would there be a significant difference between the clays

taken from the Cannelton underclay and the clays sold at Brazil, Indiana, for sewer-pipe clay?

A. I would like to clarify that question. You are asking me if there is a difference in properties and mineralogy? [fol. 156] 102 Q. A significant difference for use in making sewer pipe.

A. I don't have the data right at hand, so I have to think a little bit on this one. The State Highway Department maintains a testing laboratory at Purdue University where they test sewer pipe that is used by the State Highway. The Cannelton Sewer Pipe, in the history of the postwar years, has had the best sewer pipe that is made in Indiana. The absorption is low; it tends to be more uniform. So on that basis, I would say that the raw material at Cannelton for use as sewer pipe is slightly better than that at Brazil.

103 Q. Would you call that a significant difference in the material, or could that be due to manufacturing processes and know-how?

A. In part it is due to both.

104 Q. Are you willing to state that the material in the Brazil area and the Bloomingdale area are not satisfactory for use in making good vitrified sewer pipe?

A. No, sir.

105 Q. That would be satisfactory for use in making good vitrified sewer pipe?

A. Yes, sir.

106 Q. Do you know the transportation costs from Brazil, Indiana, to Cannelton, Indiana?

A. No, sir.

107 Q. You stated awhile ago that you could pass on an economic opinion as to whether or not it would be profitable to bring clay from Brazil, Indiana, to Cannelton, Indiana.

A. I was answering a question in a specific sense. I don't know the cost of the transportation of this item from Brazil to Cannelton. I know that you can not transport raw materials any great distance and that the transporta- [fol. 157] tion costs from Brazil to Cannelton would definitely be too great to make it profitable.

108 Q. Do you know how much it would cost, approximately, even? You are passing an opinion based on a cost. Do you have any idea of what it costs?

A. This is by truck?

109 Q. By the most economical method. I assume there is rail transportation.

A. You wouldn't get rail transportation, because you would have to switch too much, so it would have to be by truck. It would be on the order of $5.00 a ton.

110 Q. To transport it 150 miles?

A. Right.

111 Q. Do you know if rail transportation would be that high?

A. It would depend upon the rates.

112 Q. Do you know if rail transportation is normally that high, $5.00 a ton?

A. I can only speak on the basis of Georgia Kaolin Company. I can't give you any idea on the rates in Indiana.

113 Q. If it costs $3.50 a ton to extract the clay from their underground mine in 1951, would it still be your opinion that it would be uneconomical for them to buy clay from the Huntingburg area, to Cannelton?

A. I don't think this question——

114 Q. (Interposing) Would you just answer the question, Doctor?

A. I will say no, it would not be.

115 Q. It would be uneconomical?

A. Yes.

116 Q. It would cost them more than $5.00 a ton to get clay from Huntingburg to Cannelton?

A. No; the transportation cost would not be that high.

[fol. 158] 117 Q. Do you know at what price clay sold in the Brazil area in 1951?

A. Well, this will have to be a qualified statement. As I remember, the costs were about $1.80 a ton. I don't want to state that as a positive statement, because that price changes so rapidly, and I don't remember that that was an absolute figure.

118 Q. You stated you had some familitarity with the Kentucky production of ceramics. Are you familiar with the work of the Owensboro Sewer Pipe Company?

A. I am not familiar with it. I know just in a general way what they used, and where they got their clay from, but I am not familiar with their plant.

119 Q. Where did they get their clay from?

A. From the vicinity of Hawesville, Kentucky.

120 Q. Do you know whether this material was satisfactory for making commercial sewer pipe?

A. It apparently was.

121 Q. Do you know how far Hawesville is from Cannelton?

A. It's just across the river, about a half a mile.

122 Q. And it is about 12 miles from Owensboro, then?

A. Yes.

123 Q. So, when you stated that the closest sewer-pipe clay to the Cannelton area in Indiana was the Huntingburg area, you, of course, didn't mean that?

A. Sewer pipe is made at Brazil; not Huntingburg.

124 Q. The closest place they make sewer pipe is Brazil?

A. Yes. I was not including any other state; just Indiana.

125 Q. Did you realize that they were making it in Kentucky, just a few miles from Cannelton?

A. About 15 miles, yes.

[fol. 159] 126 Q. Did you know if this is a satisfactory sewer pipe that they make in Owensboro?

A. I can not state that. I have no basis of knowing what the tests were. I have never tested their material.

127 Q. Is there a significant difference for the purpose of making sewer pipe between the clay mined at Cannelton in 1951 and the clay which they are now taking from the Kentucky side of the Ohio River?

A. That I can not answer, because I haven't tested the clays that they are now using.

128 Q. You know that they are now making sewer pipe from those clays?

A. I know that they are, yes.

129 Q. Going back to your definition of fire clay, how would you disagree with the American Society for Testing Materials', which you have referred to as A.S.T.M., definition of fire clay?

A. I would have to see the definition. I don't remember what it is.

130 Q. This is my penciled copy of the definition taken from the Manual of A.S.T.M. Standards on Refractory Materials, Page 129, A.S.T.M. C 71-51, which was revised in 1951.

A. It is a very general definition, but I would say it is essentially correct.

131 Q. So that when it states that fire clay is an earthy or stony mineral aggregate which has as the essential constituent hydrous silicates of aluminum with or without free silica, plastic when sufficiently pulverized and wetted, rigid when subsequently dried, and of suitable refratoriness for use in commercial refractory products, you would agree with that definition?

A. Yes.

132 Q. So any material which was not of suitable refractoriness for use in commercial refractory production, would not be a fire clay?

[fol. 160] A. State that again.

133 Q. Any clay which was not of suitable refractoriness in use of commercial refractory products would not be a fire clay?

A. Any material that could not be used——

134 Q. (Interposing) To make commercial refractories.

A. No. Any material that could not be used for a refractory.

135 Q. Now, you agree with the words "commercial refractory" in this definition, do you not?

A. Yes.

136 Q. So, your difference is one that doesn't relate to the commercial world; it relates to your definition as a clay mineralogist?

A. Any material that has a refractoriness, we'll say it will withstand temperatures of 2600 Fahrenheit, will make a refractory, a low grade refractory provided it has these other properties.

137 Q. It is suitable for commercial refractories, then, wouldn't it be?

A. Yes.

138 Q. If it had what other properties?

A. The looseness and the composition of hydrous silicates.

139 Q. Do you know if they make any refractories at Cannelton Sewer Pipe Company?

A. I do not know. To my knowledge, they do not. But I can not state that definitely.

140 Q. Are there other things other than pyrometric cone

equivalent, other than material, that would make a suitable refractory? The fluxing quality of the material would have something to do with it, wouldn't it?

A. Yes. There are many other factors, but the essential [fol. 161] ingredient, the one most desired is the pyrometric cone equivalent.

141 Q. That is the point from which ceramic engineers begin?

A. Right.

142 Q. But they do look at other things, whether or not they can use as a refractory?

A. Yes.

143 Q. And if this material wasn't being used, or hadn't been used, you wouldn't have a satisfactory test, then, as to whether or not it was used satisfactorily?

A. On the basis of the work we did as the Indiana Geological Survey, it would be suitable to make a low-duty fire brick.

144 Q. Is that based on the cone equivalent?

A. On shrinkage, pyrometric cone equivalent, plasticity.

145 Q. What other requirements of a low-duty refractory is there, as you have termed it in terms of pyrometric cone equivalent?

A. The definition of a low-duty refractory material is that which will withstand temperatures between—pyrometric cone equivalent of 19 is the lowest.

146 Q. Nineteen is the lowest?

A. Yes.

147 Q. If some of them went below 19 in the test, would you say it wouldn't be suitable for low-duty refractory?

A. Of what?

148 Q. The clay samples taken from the Cannelton mine, if they went below 19, would you say they were suitable for refractory purposes, for low-duty refractory?

A. No. I would have to know what the sample was and how it was taken, because by proper blending, they can utilize the materials.

[fol. 162] 149 Q. Do you mean blending with higher-grade materials? Is that correct?

A. Right.

150 Q. But the material, itself, would not be a refractory suitable for use in making a low-duty refractory?

A. Only on the definition that Norton gave. There are other definitions that say 2600 or Cone 15. You will notice on A. S. T. M. they give no temperature minimum.

151 Q. Do you know if the A. S. T. M. has ever taken a position on pyrometric cone equivalence for a low-duty refractory?

A. I do not.

152 Q. If the A. S. T. M. had always used the pyrometric cone equivalent of 19, would that tend to make you think that the commercially understood meaning of the term would include only those which have a P. C. E. of 19?

A. Not necessarily, because there are a number of authorities who have written text books and other material about refractories that have used Cone 15 or 2600° Fahrenheit.

153 Q. What refractory uses can you use a Cone *is* refractory clay?

A. Well, it would be a low-duty fire brick that can be used for lining furnaces.

154 Q. Have you ever known of any example where low-duty fire brick has gone as low as 19 in pyrometric cone equivalent?

A. As low as 19?

155 Q. As low as 15 in P. C. E., lining a furnace?

A. I have no personal experience from which to draw on to answer that question.

156 Q. You don't know?

A. I don't know personally. There must be because of the literature.

[fol. 163] 157 Q. Could the literature be based upon the determination that ladle brick may be necessarily of a low pyrometric cone equivalent, or are you familiar with the use of ladle brick and how it is applied?

A. Yes, in a general way.

158 Q. It must flow in order to close up the crack, isn't that correct?

A. I don't know, I can't answer that question. There are no ladle brick, as such, made in Indiana.

159 Q. Do you know if the Bruce Williams Laboratory is a reliable organization, from your experience, located at Joplin, Missouri?

A. I am not familiar with the organization.

160 Q. I hand you what has been furnished the Government by the taxpayers, a copy of an analysis made by the Bruce Williams Laboratory, and ask if you can testify that as to whether considering all the facts on that page, that material would be used in making a low-duty refractory brick?

A. Based on some definitions, it could be.

161 Q. A low-duty refractory brick?

A. Yes.

162 Q. Not rather than a ladle brick?

A. I can't answer that, because I don't know. Another thing, you would have to know if this were a composite of the whole face that included the lower one foot of shale in this mine, then, of course, your refractoriness would be down to Cone 17. If it were the fire clay, as such, our experience has shown it's above Cone 19.

163 Q. If the miner mined the material indiscriminately, taking the shale and clay together, and the shale was a pyrometric cone of 10, as indicated in your test, would the product, that which is removed from the mine without differentiation, be fire clay?

[fol. 164] A. I can't answer that specifically, because you will be in a ratio of approximately six to one, the mixture, and I don't know how much the shale would take it down, would take the pyrometric cone equivalent down.

164 Q. If it was 40 cent shale and 60 per cent fire clay, could you say how much it would take the pyrometric cone down?

A. I can not.

165 Q. It would depend upon individual test of the material, is that correct?

A. Right. The fire clay, as such, would be fire clay. The shale would be shale. That's all I can say about it.

166 Q. You recognize a distinguished difference between the two?

A. Yes, sir.

167 Q. And they are terms of art which refer to specific types of formations in the ground?

A. Yes, sir; the shale. Fire clay is an economic term. Underclay is the general term for clays that occur under coal. Fire clay is an economic term. It has no genetic significance.

168 Q. Going back to the economic aspects of hauling clay, are you familiar with the Louisville Pottery Company?

A. I am familiar with their mine at Huntingburg. I have never been in the Louisville Pottery Company.

169 Q. They have a mine at Huntingburg?

A. They did have a mine at Huntingburg.

170 Q. In 1951, do you know whether they had a mine in Huntingburg?

A. Well, I believe the Uhl Pottery Company was operating that at that time. After that, Louisville took over. I don't remember specifically whether Louisville had a mine there in 1951 or not.

[fol. 165] 171 Q. Do you know how far Louisville is from Huntingburg, approximately?

A. Oh, approximately 60 to 65 miles.

172 Q. Did you know that they took the clay from Huntingburg into Louisville?

A. Yes, sir.

173 Q. Do you know if this clay that was being taken from Huntingburg to Louisville was significantly different than the clay that is mined at Cannelton for the purpose of making a sewer-pipe product?

A. It has a different end use, your pottery being a more expensive material. They can afford to have a higher cost of raw material under those arrangements. The material, as such, is the material that they use for a low-duty fire brick at Huntingburg. The Huntingburg Brick Company uses the same clay to make their low-duty fire brick.

174 Q. Your determinations as to whether it would be economically feasible would depend, then, on whether they could make sufficient profit to absorb that cost?

A. That is the case in every raw material that is used.

175 Q. So, if at Cannelton they could make sufficient profit to absorb the cost of clay from Huntingburg or Brazil, then your testimony would change and you would say that it would be economically feasible?

A. Every clay operation in this country is based on economics and transportation today, and is a significant factor, clay being a low-priced commodity, as such. You have to consider transportation.

176 Q. I hand you, Dr. Murray, what the reporter has marked for identification Government's Exhibit A, entitled DIRECTORY OF PRODUCERS AND CONSUMERS OF CLAY AND SHALE IN INDIANA by the Indiana Department of Conservation, [fol. 166] GEOLOGICAL SURVEY, Directory No. 3, dated 1955. I assume you are familiar with this pamphlet.

A. Yes.

177 Q. From what source did you get the information that is reported as to the individual producers?

A. This information was collected from either the owner, general manager, or the superintendent of each operator listed in here.

178 Q. Did you go to the plant in each case?

A. I did.

179 Q. Do you believe the information there to be correct in all respects?

A. It is correct so far as the information that they gave me. I reproduced the information that was given to me.

180 Q. When you have listed a pit location, you know that there was a pit located there, is that correct?

A. There was a pit located there.

181 Q. And when you state in this publication that there were purchases of underclay from the Brazil Area, you know that they were purchasing underclay?

A. At the time that I visited the operation, based on their word, yes.

182 Q. During what period of time did you compile this?

A. The information was first collected in the summer of 1950 and rechecked in 1954. This was published in 1955.

183. Q. I don't want to ask you about all of these, but I would like to ask you about specific ones.

Do you recall in the process of preparing this that there were a number of producers who mined clay and shale only for sale in that they did not produce ceramic products from clay and shale?

A. There are relatively few in Indiana, but there are some.

[fol. 167] 184 Q. Would the Big Bend Collieries at Brazil be one of those?

A. They were at the time. They are defunct now.

185 Q. Do you know if they were in existence in 1954?

A. They were.

186 Q. And it says a capacity of 5000 to 6000 tons per month. That doesn't refer to production; that refers to capacity?

A. That is capacity. They could produce that in an optimum month. They didn't operate some months.

187 Q. Do you know that they were producing clay and shale for sale in 1951?

A. Yes, sir.

188 Q. Would the Brown Coal Company, of Centerpoint, in Clay County, be another one of those producers?

A. Yes.

189 Q. Do you know if they were producing in 1951?

A. I don't believe they were producing in 1951. They started in about 1953.

190 Q. Producing clay for sale?

A. All these coal companies, their prime objective is to sell coal, but when they strip off the coal, the clay is laid bare, so that they can just increase their profits if they can remove the clay at the same time they remove the coal. Many times they will leave the clay lie there, because there is no market for it. There are a number of coal producers in the Brazil area, as you probably know, so that there isn't a market for all of the clay that could be produced.

191 Q. Well, it states that they purchased underclays of coals near Bloomingdale. That particular producer was purchasing these underclays that these coal companies and other people were selling, is that correct?

[fol. 168] A. That is right.

192 Q. Are you familiar with the Bureau of Mines Minerals Year Book, and the way they accumulate the figures for those?

A. In a general way, yes.

193 Q. Do you know how they accumulate the figures on clay?

A. From Indiana?

194 Q. Yes.

A. They use a mineral statistician at the Indiana Geological Survey from which they get their data.

195 Q. Do you know where he gets his data?

A. From the individual producers.

196 Q. If the producers tell that statistician that he is

purchasing his clay in a certain amount, he would take that figure as correct?

A. Yes, sir.

197 Q. And if he called his clay a "fire clay," it would go into the category of a fire clay in those publications?

A. The person who takes in the data is not geologically or ceramically trained. It is a girl, and all she does is act as an intermediary between the producers and the Bureau of Mines.

198 Q. And if I told you that during 1951 some 300,000 tons of fire clay were sold in the State of Indiana, rather than used by producers in the State of Indiana, would you think, in your experience, that that figure was substantially correct?

A. In Indiana, it probably is, because 99 per cent of the clay that is sold is in the Brazil area.

199 Q. Would you think the figure would be correct, or does your experience indicate that it would be reasonably correct?

A. Yes.

[fol. 169] 200 Q. Now, how far is Bloomingdale from Brazil?

A. It is 20 or 25 miles.

201 Q. Do you know that they also produce clay and shale for sale in that area?

A. There is a clay pit at Bloomingdale.

202 Q. Do you know if they sell clay in the crude form from that pit?

A. Yes, they do.

203 Q. Now, at Bloomingdale, Brazil, Huntingburg, and Cannelton, they are all in the Pennsylvanian formation?

A. Right.

204 Q. And the clays that are mined in those areas all come from the Pennsylvania formations?

A. Yes.

205 Q. Different parts of those formations?

A. Yes.

206 Q. Do you believe the information contained in this Directory No. 3, prepared by you, to be substantially correct?

A. As of the date of preparation, based on the information that was given to me, yes."

Mr. Friesen: (For Deft.) I will have to have this copy marked Government's Exhibit A. I can't find the one originally marked.

(The defendant, for purposes of identification, handed the reporter a certain document for marking, and which was by said reporter marked Government's Exhibit A.)

"Mr. Friesen: I offer in evidence Government's Exhibit A.

Mr. Travis: No objection."

The Court: There being no objection, Government's Exhibit A is admitted, read, and exhibited in evidence.

[fol. 170] (Government's Exhibit A is admitted and read into the evidence, and made a part of the record in this case, said exhibit being in the words and figures following, to wit:)

(Here Insert.)

Mr. Friesen: (For Deft.) Government's Exhibit A is a directory, and you will notice they list where each producer purchased and from the source he was purchasing, and includes—I have underlined two or three, perhaps as many as 10, in red pencil. Those interlineations are my own, and, of course, were not in it. The interlineations, one in particular, shows the American Art Clay Company, Inc. purchased Minshall underclay from Huntingburg, and used as well imported domestic clays.

The Court: You may proceed.

207 Q. Dr. Murray, you have prepared another pamphlet, PENNSYLVANIAN UNDERCLAYS—POTENTIAL BONDING CLAYS FOR USE IN FOUNDRIES.

A. Yes.

208 Q. And in the process of writing that paper, you examined Cannelton clay from their mine, is that correct?

A. Yes.

209 Q. Did you find it to be what you would recommend as bonding clay for use in foundries?

A. No.

210 Q. Would you consider that to be a refractory clay?

A. No. That is based on the fact that the largest tonnage of foundry clay is bentonite, which is not refractory in any sense of the word.

211 Q. Does it need to be resisted to high temperatures?

[fol. 171] A. Not necessarily, because you use such a small amount of clay. Your silica content of the mold absorbs most of it. All you need is a bond between the silica and the bentonite. You just use two to five per cent, approximately, to bond these molds.

212 Q. Do you recall why this particular material was not satisfactory, and the specifications?

A. The green strength was too low to be used as a satisfactory bonding material. The one important aspect of foundry clay is that it has to have a high green strength; that is, so it will retain the shape in which you mold it, and this material from the Cannelton area had a low green strength.

213 Q. When you refer to "underclays," do you always mean it actually came from underneath the coal seam?

A. In some cases the coal had been eroded away or removed. There are inconformities in the rocks where there has been a previous history of no deposition, and in those cases, the coal has been removed, so we know coal had to be there at one time because the underclay is the material in which the vegetation grew to form the coal. But as we see it now, it does not necessarily mean the coal has to be there at the present time.

214 Q. You testified that fire clay is not a term of mineralogical designation, but a commercial term.

A. I didn't say mineralogical; I said genetic, so far as origin is concerned. Mineralogically, it has a certain cone, because the results of physical tests are all based on the original mineralogy.

215 Q. Would you say that all fire clays are underclays?

A. No.

216 Q. Would you say that all underclays are fine clays?

A. No.

[fol. 172] 217 Q. So they are not synonymous terms in any sense?

A. No.

218 Q. You would disagree with anyone who said they were?

A. Yes.

Mr. Friesen: I have no further questions at this time.

Redirect examination.

Questions By Howard P. Travis:

219 Q. Dr. Murray, the two mines that you have visited of the Cannelton Sewer Pipe Company were right across the road from each other, is that correct, or substantially?

A. Substantially.

220 Q. They were the same vein of clay, were they?

A. Yes, they were both the Cannelton clay.

211 Q. Then the various tests that you have made in different years, has there been any significant variations in those?

A. Not between those two mines.

222 Q. Doctor, sewer pipe, as such, produced by the Cannelton Sewer Pipe Company, is not a refractory product, is it?

A. No.

Mr. Travis: That is all.

Recross-examination.

Questions By Ernest C. Friesen, Jr.:

223 Q. Then you say that there no significant variations between the two mines. There were variations, I assume, between the two mines, were there not?

A. There are variations, if you want to take it on a fine [fol. 173] scale, but over-all working properties in the plant production scheme are not significantly different. It didn't alter the properties of the sewer pipe when they went from one mine to another.

224 Q. In 1954, one test showed an SIO2 of 63.21, and another test made six months earlier showed an SIO2 of 69.75. Would you call that a significant variation?

A. I can't say, because the SIO2 doesn't tell you what the mineralogy of the material was. You see, one of those could have more free quartz, or more kaolinite, which would have a high silica ratio. It would depend entirely on the way the silica was combined in the mineral. Chemical analyses are dangerous things to base properties on.

225 Q. How would you distinguish properties, then, in determining whether there was a significant difference?

A. I don't believe I quite understand.

226 Q. You said that a chemical analysis is not a satisfactory basis for the determination. What is?

A. Chemical analysis alone is not a satisfactory basis for determining resultant physical properties. Mineralogical analysis and a few physical tests are always needed in raw materials.

227 Q. Mineralogical data that you would like to know about. Would that be a percentage of kaolinite?

A. Kaolinite and other minerals that might be in there. You see, the clays themselves have different properties. Koalinite is an entirely different property than Montmorillonite, so that mineralogy is a very important factor. The silica content of Montmorillonite is higher than that of kaolinite.

228 Q. If there was a variation of five per cent in the kaolinite content from one sample to another, would you [fol. 174] consider it to be significant for purposes of making sewer pipe?

A. No.

229 Q. If there was a variation of as much as two per cent in the fluxing ingredient, would you consider it to be significant for the purpose in making sewer pipe?

A. Well, of course, there is a critical value, so that it would depend where you are in relation to this critical value, and I don't know what that critical value is.

230 Q. What are the fluxing agents generally found in Pennsylvanian clays?

A. Well, there are minor quantities of calcium carbonate in some very small amounts. There are small amounts of this mineral Montmorillonite that I mentioned which vitrifies at low temperature, iron compounds—there are many.

231 Q. You might find some magnesium carbonates, too?

A. Yes. There might be a possibility of finding a small amount of dolomite which is a calcium magnesium carbonate.

232 Q. There is some potassium oxides, too, is there not?

A. Not oxides, as such. The are tied up with the clay mineral, illite, which is a potassium alluminum silicate that is found in all of the underclays in Indiana.

233 Q. Is that considered to be a fluxing clay or material in a clay?

A. Not necessarily. It is the same mineral as muscovite, except it is in very small particles.

234 Q. Dr. Murray, what I am trying to get at is what you consider to be a significant difference for purposes of making sewer pipe. You have used the term several times that you didn't think that was a significant difference be-
[fol. 175] tween the deposits. What do you mean when you use that term?

A. Well, I am talking about the end product properties. They went from the mine on the south side of the road to the mine at the north side of the road, and by proper testing in their own laboratory at Cannelton they make a product that was essentially the same, and the raw materials that they used were from the same age clay deposit. They could use these materials without changing their procedures so that they were significantly the same materials to work with.

235 Q. Then your answer seems to be they were still suitable for use in making sewer pipe, is that correct?

A. They were both a refractory material which would class these two clays as fire clays, and they could be used in making this sewer pipe.

236 Q. So that if there are other materials that were suitable for making the same quality of sewer pipe, or quality sewer pipe, there would be no significant difference between the materials, is that correct?

A. I know that the Cannelton Sewer Pipe has done a lot of investigating in the area for other clays. They have found none, to my knowledge, in Indiana that have the refractoriness of these clays that they were using back in 1951 and 1952.

237 Q. At least, they haven't found any as close as they can find them in Kentucky, is that correct?

A. That is correct, and I don't know the refractoriness of the clay in Kentucky. I know that Cannelton Sewer Pipe, because it has used this fire clay in their product, was a very, very good product from the results of the State Highway Testing Laboratory. It had a very low absorption which is the result of using this fire clay and, as a result of using fire clay, their maturing temperature was higher, so they got a better body.

[fol. 176] Mr. Friesen: I think I have no further questions.

Mr. Travis: That is all.

And Further Deponent Saith Not."

The Court: Do you have any further witnesses this afternoon?

Mr. Travis: (For Pltf.) I have none. At this time the plaintiff will rest.

The Court: You say "plaintiff rests." Subject to the original agreement of the production of one additional witness?

Mr. Travis: (For Pltf.) Yes.

(At this time the Plaintiff rests subject to agreement as made between counsel for plaintiff and counsel for defendant.)

The Court: We will stand recessed until two o'clock.

(Whereupon the Court was recessed at 12:10 p.m., to reconvene at 2:00 p.m. this date.)

Indianapolis, Indiana, March 12, 1958, 2:04 o'clock p.m.

(The Court met pursuant to adjournment, and the trial was resumed as follows:)

The Defendant, to further maintain the issues in its behalf, offered and introduced the following evidence, to-wit:

[fol. 177] EUNICE LANDGREBE, a witness called on behalf of the defendant, being first duly sworn, testified as follows:

Direct examination.

Questions by Mr. Friesen:

1 Q. Would you give the Court your full name?

A. Eunice Landgrebe.

The Court: How do you spell your last name?

The Witness: L-a-n-d-g-r-e-b-e.

2 Q. Where do you live?

A. Huntingburg.

3 Q. Huntingburg, Indiana?

A. That's right.

4 Q. Are you associated with a business in Huntingburg?

A. Huntingburg Brick Company.

5 Q. And what is your position with that company?

A. I am President of the company.

6 Q. How long have you been associated with that company?

A. Since 1947.

7 Q. Do you own your own mine or pit at Huntingburg?

A. Yes, sir.

8 Q. And what is the form that your mine or pit takes there?

A. It is an underground mine. We have a tipple.

9 Q. And do you know if there are any other underground mines in the Huntingburg Area?

A. Yes. We use an elevator system, and they use a slope mine.

10 Q. What other companies have mines in that area?

A. Well, it is not any company; just an individual. He has a little mine there that we purchase clay from.

[fol. 178] 11 Q. Does the Louisville Pottery Company have a mine there?

A. Well, now, I believe they still have it.

12 Q. Do you know if they had one in 1951?

A. I couldn't prove it. I think they did. There is a mine out there, and I understood it belonged to the Louisville Pottery.

13 Q. During the Year 1951 did you purchase any clay for the production of your ceramic products?

A. Yes, sir.

14. Q. And how much clay did you purchase during that year?

A. 4,438 tons.

15 Q. Have you taken this figure from the books and records of the company?

A. Yes, sir.

16 Q. And what price did you pay for that?

A. $3.25 delivered at the plant.

17 Q. Is this also shown on the books and records of your company?

A. Yes, sir.

18 Q. Do you know what kind of clay you mine?

A. It is called fire clay.

19 Q. Do you know what kind of clay you purchase?

A. Fire clay.

20 Q. And do you know the—if that—both of those clays come from underneath a coal seam?

A. Well, ours does, yes, I am sure they do, because our better clay did come from underneath the coal, just a small amount of coal.

21 Q. You have testified that you own your own mine and that you purchased clay from another mine in the Huntingburg Area during 1951. Why didn't you mine all the clay that you needed for yourself?

A. Well, sir, at the time I didn't have enough clay. [fol. 179] My capacity at the mine was not enough to fill my orders, and I had to purchase some.

22 Q. What is the capacity of your mine?

A. Well, I would say 40 tons, about 40 tons a day.

23 Q. And you needed more clay in order to fill the orders that you had in 1951?

A. That's right, sir.

24 Q. Did you purchase clay prior to 1951?

A. '50.

25 Q. Have you purchased clay since that time?

A. Yes, sir.

26 Q. Ever since that time?

A. '52, '53, '54, yes, sir, I have.

27 Q. Since '50?

A. Yes.

Mr. Friesen: (For Deft.) Would you you mark this Government's Exhibit G for identification?

(The defendant, for purposes of identification, handed the reporter a certain object for marking, and which was by said reporter marked Government's Exhibit G.)

28 Q. (By Mr. Friesen) Mrs. Landgrebe, I hand you what has been marked for identification Government's Exhibit G and ask if that is a brick which has been manufactured by your company?

A. Yes, sir.

29 Q. How can you tell that was manufactured by your company?

A. Well, our name is on the back of it.

Mr. Friesen: (For Deft.) Your Honor, I call the Court's attention to the similarity in color with the clay used by

the plaintiff, as shown on Plaintiff's Exhibit 11, and the [fol. 180] like similarly with the Plaintiff's Exhibit 16, which was identified as shale taken from the plaintiff's mine.

I offer the Government's Exhibit G.

(Government's Exhibit G was offered in evidence at this time by Mr. Friesen.)

Mr. Travis: (For Pltf.) No objection.

The Court: It is admitted and exhibited in evidence.

(Government's Exhibit G is admitted into the evidence, and made a part of the record in this case, said exhibit being in the words and figures following, to-wit:)

(Here Insert.)

30 Q. (By Mr. Friesen) What was the form of the clay that you purchased in 1951? By this question I mean was it ground and screened before it was delivered to you?

A. No, sir.

31 Q. Was it delivered in the form that it was brought out at the mine?

A. That's right, sir.

Mr. Friesen: (For Deft.) I have no further questions.

Cross-examination.

Questions by Mr. Travis:

32 Q. Mrs. Landgrebe, whom did you buy the clay from in 1951?

A. It was the old Uhl mine.

33 Q. U-h-l?

A. That's right.

34 Q. That was owned by Louie Uhl?

A. Uhl Pottery.

35 Q. Were they in business then?

[fol. 181] A. No, they were not.

36 Q. What happened to them?

A. The Uhl Pottery?

37 Q. Yes, the pottery part.

A. Well, one thing, they had labor trouble at the mine, and he didn't want to fool with it. He had so much money he didn't know what to do with it, so he just quit.

38 Q. Then so the Uhl Pottery from whom you purchased this was no longer using any clay of their own?

A. No. He just moved away, and it was there.

39 Q. Isn't it true Mr. Uhl came to you and asked you to take some clay from him, because he had some more clay left in his mine and wanted to mine it to have a little something to do?

A. No, he didn't do it.

40 Q. He owned it . . .

A. (Interposing) He thought he could make more money off of it, and I was very glad to get it.

41 Q. And you didn't have enough clay in your own mine at that time to satisfy your own production?

A. That's right, sir.

42 Q. What do you make up there?

A. We make brick like this (Referring to Government's Exhibit G), and, then, we use different faces on the brick and what they call second-grade fire brick.

43 Q. You make a fire brick?

A. A brick like this, only solid.

44 Q. Brick out of the same clay you are talking about?

A. Yes, that's right.

45 Q. That is a refractory product?

A. That is what it was.

Mr. Travis: (For Pltf.) I have no further questions, that's all.

[fol. 182] Mr. Friesen: (For Deft.) I have no further questions.

The Court: Did Mr. Uhl have any interest in your company?

The Witness: He does not.

Mr. Friesen: (For Deft.) You may step down Ma'am. Mrs. Landgrebe would like to be excused with the Court's approval.

Mr. Travis: (For Pltf.) She may leave as far as we are concerned.

The Court: You may be excused.

The Witness: Thanks a lot.

(Witness Excused)

JAMES EDWARD EDER, a witness called on behalf of the defendant, being first duly sworn, testified as follows:

Direct examination.

Questions by Mr. Friesen:

1 Q. Would you give your full name, please?
A. Mr. James Eder.
2 Q. Where do you reside, Mr. Eder?
A. Brazil, Indiana.

The Court: How do you spell your last name?
The Witness: E-d-e-r.

3 Q. (By Mr. Friesen) Are you associated with a business in Brazil?
A. Yes.
4 Q. What is that business?
A. Log Cabin Coal Company.
5 Q. Do you do business under any other name?
A. No.
6 Q. What product does the Log Cabin Coal Company produce?
[fol. 183] A. Mostly clay now.
7 Q. Are you producing any coal now?
A. Scarcely any, just a little, what little we run across.
8 Q. Your main production is clay?
A. That's right.
9 Q. In 1951 were you producing both coal and clay?
A. Well, mostly clay then, I think; yes, still mostly clay.
10 Q. Would you say you were in the business of producing clay in 1951?
A. We had just started it.
11 Q. Did you sell clay in 1951 from property owned or leased by you?
A. The clay we produced it was either leased or owned by us at that time.
12 Q. Where did you sell it?
A. In and around Brazil.
13 Q. To whom did you sell that production in 1951?
A. Most of it, I think all went to Arketex, I believe.
14 Q. Arketex?
A. Yes.

15 Q. Do you know how to spell that?

A. A-r-k-e-t-e-x Ceramic Corporation.

16 Q. Do you know what product they produce?

A. Well, it is a glazed ceramic tile.

17 Q. Would you describe it as a structural tile?

A. I suppose that is what they do.

18 Q. What type of clay did Arketex buy from you in 1951?

A. Well, their description was a plastic clay, and what they called more of a sandy clay; but that was just a clay description.

19 Q. Was all of this clay you sold to Arketex taken from beneath coal or in what is called an "underclay"?

A. Yes.

[fol. 184] 20 Q. And where is your pit or mine located from Brazil proper?

A. Well, we have one south of Brazil, and one north of Brazil.

21 Q. How far south is the one south of Brazil?

A. About 12 miles.

22 Q. And north of Brazil?

A. About a mile.

23 Q. Do you have the figures on the tonnages of clay sold by you in 1951?

A. Yes, I have.

24 Q. Can you tell the Court how much clay you produced and sold in 1951?

A. (Witness referring to notes) At the pit north of town we sold 39,699 tons.

25 Q. And from the other pit?

A. 21,978 tons.

26 Q. And all of this was sold to Arketex?

A. I think most of it was, yes.

27 Q. Do you have the price per ton that was paid for this clay?

A. No, I haven't got it in dollars and cents.

28 Q. Do you have the total?

A. Yes, I have.

29 Q. (Cont'g) Sales?

A. Yes.

30 Q. What is the total sales' price on each?

A. The first pit, total sales, was $74,191.70.

31 Q. And on the second pit?

A. 42,525.25.

32 Q. Is that a delivered price?

A. That's right.

33 Q. Approximately how far do you deliver from the northern pit to Arketex?

A. Well, there it will average probably two and one-half to three miles.

[fol. 185] 34 Q. And from the southern pit?

A. Average somewheres around 10 miles.

35 Q. 10 miles.

A. That goes into two different factories. They are not located very close together.

36 Q. Have you continued to sell clay in the Brazil Area since that time?

A. Yes, we do.

37 Q. Are you still in fact selling clay?

A. Yes.

38 Q. Has your production increased since that time or decreased?

A. It has increased.

39 Q. Just for an example how much clay did you sell—Do you have the figures on '52?

A. Yes, I have the figures. They weren't much higher than '51.

Mr. Travis: (For Pltf.) To which the plaintiff objects for the reason '52 is not involved in the cause of action now being tried.

Mr. Friesen: (For Deft.) I withdraw the question, your Honor. I have no further questions.

Cross-examination.

Questions by Mr. Travis:

40 Q. It that a Government report you have in your hand?

A. Yes, it is.

41 Q. What is that report?

A. It's "Bureau of Mines."

42 Q. That is the questionnaire you sent in to the Bureau of Mines?

A. That's right. (Document tendered to Mr. Travis).

43 Q. On the north pit that you have described, how did [fol. 186] you describe that clay that you reported to the Bureau of Mines?

A. Well, just as a plastic clay and fire clay—fire clay and plastic clay.

44 Q. You reported it under the classification of "fire clay"?

A. That's right.

45 Q. And on the other pit?

A. Under the fire clay, the same as the other.

46 Q. Was the clay that you mined and sold in 1951 exposed from the coal?

A. Well, some of the coal had been taken off.

47 Q. The coal was gone when you started mining in '51?

A. Yes.

Mr. Travis: (For Pltf.) That's all.

Mr. Friesen: (For Deft.) No further questions.

Further Cross-examination.

Questions by Mr. Travis:

48 Q. One more thing, Mr. Eder, excuse me. We have heard the testimony of Mr. John C. Hutchinson, who is with the Ayer-McCarel Clay Company, whom you know I presume; Mr. Charles N. Smith with the G. and F. Corporation; and yours, all from Brazil. Who are the other companies, or, are the other companies in Brazil that sold clay in 1951?

A. Well, that, I don't believe I could answer.

49 Q. Don't you know all those fellows over there?

A. Big Bend Collieries was at the time, I believe, and Quality Coal Corporation.

50 Q. Which one was that? Quality Coal Corporation?

A. Yes.

51 Q. Who else?

[fol. 187] A. You have G. and F.?

52 Q. Yes.

A. I don't know if Turner Coal Company did. I think they did, too. That is about all of them.

Mr. Travis: (For Pltf.) That's all.

A. (Cont'g) Oh, yes, Manmee Collieries, that is another one.

Mr. Travis: (For Pltf.) That's all.
The Court: Redirect?
Mr. Friesen: (For Deft.) No further questions.
The Court: May this gentleman be excused, gentleman?
Mr. Travis: Yes, as far as the plaintiff is concerned.
The Court: All right, sir, you are excused.

(Witness excused.)

George C. James, a witness called on behalf of the defendant, being first duly sworn, testified as follows:

Direct examination.

Questions by Mr. Friesen:

1 Q. Give your name.
A. George C. James.
2 Q. Where do you reside?
A. Brazil, Indiana.
3 Q. And are you associated with a business at Brazil?
A. Yes, sir.
4 Q. What business is that?
A. Big Bend Collieries.
5 Q. What position do you hold with that company?
A. Auditor.
6 Q. Have you kept the books and records of the Big Bend Collieries during the period 1951?
[fol. 188] A. Yes, sir.
7 Q. What business was the Big Bend Collieries engaged in at that time?
A. Mining and shipping coal, clay, and shale.
8 Q. From what source did the coal, clay, and shale come?
A. From stripping.
9 Q. And the clay and shale you sold came from beneath the coal?
A. The clay did; the shale is above the coal.
10 Q. The clay was underclay?
A. Yes, sir.
11 Q. How much of the clay, if you know, was taken approximately?
A. Well, all we had a market for; I expect in the neighborhood of 75 per cent of the amount that was available.

12 Q. Do you know how deep you took the clay from underneath?

A. Yes, about 18 inches, 18-20 inches.

13 Q. To whom did you sell clay?

A. Well, we sold various concerns—Arketex Ceramic Corporation in Brazil; the Hill Brick Company in East St. Louis; American Terra-Cotta, Crystal Lake, Illinois; Hadley Pottery Company at Louisville, were among the customers. I don't know that I could name them all to you.

14 Q. Do you know if in 1951 you were shipping as far as Louisville?

A. I don't remember, sir.

15 Q. Do you know if you were shipping to East St. Louis at that time?

A. I am not certain of that. I don't have the records of the Receivables, of where the clay went; but I presume we were, because we had that Hill Brick account for a long time, a number of years.

[fol. 189] 16 Q. Do you know how far East St. Louis is from Brazil?

A. Around 180 miles.

17 Q. Do you know how far Louisville is from Brazil?

A. That—It is around 100 miles, I believe.

18 Q. Do you know how far it was from Crystal, Illinois?

A. Crystal Lake. That is a suburb of Chicago; that would be in the neighborhood of 170, I think.

19 Q. How was it transported in each case?

A. By rail, except Louisville, and Louisville was trucked.

20 Q. Do you have the figures with you on the tons of clay sold by you in 1951?

A. Yes, sir, 25,124.39 tons.

21 Q. Do you know how much shale you sold during that year?

A. I don't have it broken down into the calendar year. We are on a fiscal-year basis.

22 Q. What is your fiscal year ending?

A. July 31.

23 Q. Would you give us the fiscal year ending July 31, 1951?

A. In tons?

Q. Yes, please.

A. I don't have the tons totaled, either; I just have the money. Wait, do I have that on this Government report? The shale that was sold in '51 was 55,476 tons.

25 Q. Do you know to whom that was sold?

A. Yes, sir, Lone Star Cement at Greencastle.

26 Q. How far is that from Brazil?

A. That is only around 15-18 miles.

27 Q. Does the Big Bend Collieries now sell any clay?

A. No, sir, they do not.

[fol. 190] 28 Q. When did they stop selling clay?

A. In '55, 1955.

29 Q. And do you now sell any coal?

A. No, sir. We are in the process of liquidating the company, and have been since 1955.

30 Q. What was the gross, or, was the price that you charged for this underclay in 1951?

A. Well, the 25,124 tons brought $38,794.00.

31 Q. And that's—that price include any delivery cost at all?

A. No, sir. That is f.o.b. cars.

32 Q. How far were the cars from where you were producing?

A. It wouldn't be more than a mile; perhaps less than a mile.

33 Q. Do you have the price or a dollar figure on the sales of shale?

A. Yes, sir. It was a Dollar a ton.

34 Q. You sold it for a Dollar a ton?

A. Yes, sir.

35 Q. Was that a delivered price?

A. No, sir; that is f.o.b. cars, also.

36 Q. For a Dollar a ton.

A. Yes.

Mr. Friesen: (For Deft.) I have no further questions.

Cross-examination.

Questions by Mr. Travis:

37 Q. Do you know whether the Hill Brick Company in East St. Louis, Illinois, had any clay available to them in their immediate vicinity?

A. No, sir, I do not.

38 Q. Do you know that about any of the other persons to whom you sold except Arketex?

[fol. 191] A. Arketex would have, from what I have learned here today. The Hadley Pottery might have in Louisville; I don't know what type of clay they would have to have.

39 Q. What does Hadley make?

A. Pottery.

40 Q. A very high-grade material?

A. I understand it is.

41 Q. What was the company at Crystal Lake, Illinois?

A. American Terra-Cotta.

42 Q. Do you know whether they had any supply available to them any nearer than the vicinity of Clay County, Indiana?

A. I do not know. I would not think so, or they wouldn't have paid the freight rate to have Arketex ship it.

43 Q. Do you know what they used the clay for?

A. Terra-cotta ware.

44 Q. Did they blend it with any other clay?

A. I couldn't tell you.

45 Q. Terra cotta is another high-grade pottery, isn't it?

A. Yes, sir.

46 Q. And high priced?

A. I couldn't tell you. I am not in a position to know; but I think it is.

47 Q. You referred to a Government report. May I see that, please?

A. Yes, sir. (Tenders report to Mr. Travis.)

48 Q. Is it true you referred to your clay that you sold in this Government's report as fire clay, plastic?

A. Yes, sir.

Mr. Travis: (For Pltf.) That's all.

Mr. Friesen: (For Deft.) I have no further questions, your Honor.

[fol. 192] The Court: Do you know the history about Brazil over there in coal mining?

The Witness: Pretty well.

The Court: When did they start mining, strip mining?

The Witness: I think the old Big Bend Coal Company was probably the first in 1924.

The Court: 1924. There was not any stripping to speak of before then?

The Witness: Not to my knowledge.

The Court: Do they have shaft mines over there?

The Witness: No, sir.

The Court: Prior to that, I mean.

The Witness: Yes, yes, there were, yes, sir.

The Court: When did they start mining coal over there?

The Witness: I couldn't tell you. You mean the first?

The Court: Yes.

The Witness: Way beyond my time.

The Court: Do you know when these clay products companies over there, like Arketex, and so on, were established? About when, what time?

The Witness: Well, the Arketex Ceramics Corporation is the successor to the Clay Products Company, and they were in business in 1931, when I came there. I don't . . .

The Court: (Interposing) Do you know whether any of the ceramics companies over there were established as far back as 1910, 1908?

The Witness: I couldn't tell you.

The Court: All right.

Mr. Friesen: (For Deft.) Nothing more.

(Witness excused.)

[fol. 193] Carl F. Kumpf, a witness called on behalf of the defendant, being first duly sworn, testified as follows:

Direct examination.

Questions by Mr. Friesen:

1 Q. Give your full name to the Court, please.

A. Carl F. Kumpf.

The Court: How do you spell your last name?

The Witness: K-u-m-p-f.

2 Q. (By Mr. Friesen) Mr. Kumpf, where do you reside?

A. Brazil, Indiana.

3 Q. Are you associated with any business in Brazil, Indiana?

A. I am.

4 Q. What is that business?
A. Quality Coal Corporation.
5 Q. Are you an officer of that corporation?
A. I am.
6 Q. What is your office?
A. President.
7 Q. And how long have you been associated with the Quality Coal Corporation?
A. Since its beginning, July 1, 1939.
8 Q. And what—In what business does the Quality Coal Corporation engage?
A. Producers of clay, or of coal, principally, and clay.
9 Q. And in the Year 1951 were you producing coal and clay?
A. I was.
10 Q. And from what source was the clay taken by you in the Year 1951?
A. Strip-mine method, if that is what you mean.
[fol. 194] 11 Q. Was it taken from under the vein of coal?
A. Under the coal.
12 Q. And that would be from under the Brazil block coal?
A. That's right.
13 Q. How deep did you cut into the vein of clay?
A. Well, in that year we were in the Brazil Area and it would average reasonably close to 20 to 24 inches, ometimes going up to 25 or 26.
14 Q. To whom did you sell this clay?
A. In just '51?
15 Q. 1951.
A. Arketex Ceramics Corporation.
16 Q. And have you sold this same clay to any other ceramic producers in that area?
A. We have sold not in that year, but in possibly '54 or '55 we did sell clay to Poston Brick Company.
17 Q. Do you know what product they made?
A. Yes, I believe they made a face brick.
18 Q. Do you know if it was a buff brick?
A. It was a buff brick.
19 Q. Where is this clay company located?
A. Poston Brick Company is in Springfield, Illinois, and Martinsville, Indiana.

20 Q. Do you know how far it is to Springfield, Illinois?

A. It would only be a guess.

21 Q. More than a hundred miles?

A. I believe it is over a hundred miles. That would be a guess, though.

22 Q. Do you have the figures with you on the number of tons of clay you sold in 1951?

A. I do.

23 Q. How much did you sell?

A. In '51?

[fol. 195] 24 Q. Yes, sir.

A. 41,918 tons.

25 Q. And at what price did you sell that?

A. I have my figures based on f.o.b. mine.

26 Q. F.o.b. mine. What is the price f.o.b. mine?

A. $1.48, $1.4817.

27 Q. Is that the actual price you charged, or is that an average price?

A. That is what we call—got out of it after delivery; in other words, that was not the selling price of the clay because we delivered this clay into the plants.

28 Q. Do you remember what your price per ton on delivered clay was?

A. Well, in 1951 it was—I will make an honest guess, —about $1.90, I believe.

29 Q. You do not have the record?

A. I do not have the record.

30 Q. How did you come to this figure, 1.4817?

A. That was what my Office Manager figured, and it was based on our report to the Government, Bureau of Mines.

31 Q. How did you list it on your report to the Bureau of Mines, if you know?

A. We listed it as 41,918 tons at a value of $62,111.

32 Q. Under what heading on the form, if you know?

A. Plastic clay.

33 Q. Is that a sub-heading of fire clay?

A. It is.

34 Q. (Cont'g) . . . on the form. Mr. Kumpf, could you mine coal if you didn't also mine clay profitably?

A. We are not speaking in—You are only speaking of me, my operation at the present time?

35 Q. Right.

A. No.

[fol. 196] 36 Q. You absorb some of the cost of mining in the sale of clay as well as in the sale of coal, is that correct?

A. Right.

37 Q. And could you not profitably do either without the other?

A. That is what I wanted to add: You couldn't mine the clay either.

38 Q. Without mining coal?

A. That's right. I can — you an illustration of that, if you would like.

39 Q. Please do.

A. We have two mines; one is primarily in coal, and clay is a by-product. The other mine, when clay was a little short at that particular time for that type of clay, we opened up a pit where there had been deep mining and even some had been stripped over by the clay and left, so there was partial coal; so, that mine was actually started for clay with coal as a by-product, and there is a lot of difference in the price of it, too.

Mr. Friesen: (For Deft.) I have no further questions.

Cross-examination.

Questions by Mr. Travis:

40 Q. In 1951 you sold all of your sales to Arketex?

A. I am sure of that, yes, sir.

41 Q. How far was Arketex from your mine? Your delivery, in other words.

A. Well, in 1951, I would say it was about a four-mile haul.

42 Q. The difference between your estimate of $1.90 and your f.o.b. mine price of $1.48 would be your delivery cost, wouldn't it, per ton?

A. That's right.

[fol. 197] 43 Q. In these two mines do you have different types of clay?

A. They are both graded as the same clay, although they do have a different shrinkage. One has a little higher content of sand. There is a difference.

44 Q. Is one of them a higher quality?

A. No.

45 Q. Can be used for different products?

A. Can be used for the same product. The only thing is in mixing the plastic clay to hold down their shrinkage they will add a sandy clay, and that is the only difference. The ultimate outcome is the same.

46 Q. Do you know whether the Poston Brick Company in '54 and '55, either of their plants had available to them a supply of clay in the vicinity of their plant?

A. I couldn't answer that. I know they were buying themselves. Evidently they didn't have the proper layer or they would have bought it there; they would not have paid that freight.

47 Q. In 1951 you already said your principal business was coal.

A. Yes.

48 Q. Clay at that time, at least, was a by-product?

A. That's right.

49 Q. What were the tons in dollars of coal sold by your company in 1951?

A. I would not have the slightest idea.

50 Q. How much times more in value would you guess that your sales of coal were, as compared to your clay?

A. Well, in 1951, 41,900 tons of clay would not be all the clay that would have been made available.

51 Q. That is all you sold?

A. All the business we had. We had more clay available.

[fol. 198] 52 Q. What was your gross volume of business as your best guess in 1951?

A. I imagine we sold, maybe, at that time maybe a half or two thirds' the amount of clay we could have, if we would have retained it all.

53 Q. You misunderstood. What was your gross sales of coal and clay, your gross income in 1951?

A. That is going to be a guess. I imagine of coal and clay would be $480,000.

54 Q. You think that is your total volume of business in 1951?

A. I won't miss it very far.

55 Q. $480,000, of which $62,000 was clay?

A. Right. Understand I do not have those exact figures with me.

Mr. Travis: (For Pltf.) That's all.

Mr. Friesen. (For Deft.) I have no further questions.

(Witness excused.)

Mr. Friesen. (For Deft.) Your Honor, we have the deposition we would like to read, and, then, the Government will be through with its case.

(The defendant, for purposes of identification, handed the reporter a certain document for marking, and which was by said reporter marked Government's Exhibit H.)

Mr. Friesen: (For Deft.) Mr. Travis, I am asking you to examine this Directory of Coal Producers in Indiana, and I am intending to offer into evidence pages 10 through 14, of this edition, page 11 of which has already been admitted.

Mr. Travis: (For Pltf.) And 13 is.

Mr. Friesen: (For Deft.) It is just an explanation, your Honor, of what some of those charts consist, which [fol. 199] explanation is not contained on the chart. I have underlined portions of it, which, I think, is important, and I note for the record that those interlineations are my own.

Mr. Travis: (For Pltf.) I might state to you I am opposed to your doctoring up your exhibits with your underlin[illegible]

The Court: Suppose we take a few minutes' recess.

Mr. Friesen: (For Deft.) Your Honor, may I interrupt? Mr. Smith, who testified yesterday, has examined the computations which he made, and states to me that he made a misplacement of the decimal point, and it should be 18 cents per ton mile, rather than 1.8 on the short-haul distances.

The Court: Do you want to call his as a witness?

Mr. Travis: (For Pltf.) We will stipulate the 18 cents is correct, the correct figure.

Mr. Friesen: (For Deft.) Mr. Smith came back to make the record clear.

The Court: All right, we will recess a few minutes.

(Whereupon the Court was recessed at 2:50 o'clock p.m., and reconvened at 3:00 o'clock p.m., at which time the following proceedings were had:)

Mr. Friesen: (For Deft.) Mr. Travis, do you have any objection to this?

Mr. Travis: (For Pltf.) No.

Mr. Friesen: (For Deft.) Your Honor, I offer this more as background. These four pages describe some of the terminology of the codes. I will read the part which I have underlined:

> "Names which the Indiana Geological Survey uses in a stratigraphic sense are Lower Block, Upper Block, Minshall, Coal II, Coal III, Coal IV, Coal V, Coal VI, and Coal VII. Some of the names which are used [fol. 200] locally or which are trade names are Lower Cannelton, Upper Cannelton, St. Meinrad, Shoals, Huntingburg, Jasper, Buffaloville, Lower Millersburg, and Upper Millersburg. Trade names also are used for the more widespread coals. Coal V, for example, has been called Alum Cave, Glendora, and Petersburg, and the Upper and Lower Block coals have been called Brazil Block and Block."

I call the Court's attention to page 13, which has been identified otherwise as an exhibit. If you notice the line which divides the Coal III from the Lower and Upper Block coals and the coals contained in the southern part of the State, runs in an area which includes Cannelton, all the way, way up; includes Clay County, and this classification below the Coal III is further illustrated on page 11, which is also an exhibit introduced by the plaintiff.

(Government's Exhibit H was offered in evidence at this time by Mr. Friesen.)

The Court: Show Government's Exhibit H admitted, read and exhibited in evidence.

(Government's Exhibit H is admitted and read into the evidence, and made a part of the record in this case, said exhibit being in the words and figures following, to-wit:)

(Here Insert.)

The Court: Call your next witness.

Mr. Friesen: (For Deft.) I would like now to read the deposition of Mr. L. R. Chapman.

Mr. Travis, will you agree to dispense with the reading of the preliminary matter?

Mr. Travis: (For Pltf.) Yes.

(At this time the deposition of L. R. Chapman was read into the record by counsel for plaintiff and counsel [fol. 201] for defendant, said deposition, as read, being in the words and figures following, to-wit:)

"Mr. L. R. Chapman, having first been duly sworn, deposed and said as follows, to-wit:

Direct examination.

By Mr. Ernest C. Friesen, Jr.

Mr. Friesen: Give your full name, Mr. Chapman.

Mr. Chapman: L. R. Chapman.

2 Q. And where do you reside?

A. My home, or business?

3 Q. I'd like to get both. Where is your home?

A. Tell City, Indiana.

4 Q. And where are you in business, of——

A. (Interrupting) Lewisport, Kentucky.

5 Q. Are you associated with any firm or company?

A. Yes, sir.

6 Q. And what is that company or firm?

A. L. R. Chapman, Inc.

Mr. Travis: That's L. R. Chapman, Inc.

7 Q. And what is the business of L. R. Chapman, Inc.?

A. Coal mining, farming, and construction work.

8 Q. And were you associated with L. R. Chapman, Inc., during the period 1949 through 1957?

A. Yes, sir.

9 Q. Was—what was the business—business of the L. R. Chapman, Inc., during the period 1949, 1950, 1951, 1952?

A. The same.

Mr. Travis: Just a minute. Plaintiff objects to any questions not relating to the year 1951."

The Court: Overruled. It is a preliminary matter.

[fol. 202] 10 Q. "Mr. Chapman, do you own property in the vicinity of Lewisport, Kentucky, and Hawesville, Kentucky?

A. Yes, sir.

11 Q. And what is the nature of the property?

A. Well, land.

12 Q. Now, generally speaking, where is the land located, in what county or counties?

A. Hancock County.

13 Q. It's all located in Hancock County?

A. Yes, sir.

14 Q. And how much land do you own in Hancock County, approximately?

A. Approximately twenty-eight hundred acres.

15 Q. Now, you have testified that in your business of —or the corporation is in the business of mining coal. Is that in Hancock County?

A. Yes, sir.

16 Q. Do you find any other valuable mineral product as a result of mining coal in Hancock County?

A. (Witness in thought).

17 Q. Let me put it this way, do you uncover clay and shales as a result of—of mining coal?

A. Yes.

18 Q. And do you personally use this clay and shale which is uncovered——

A. (Interrupting) No.

19 Q. (Continuing) —in the process?

A. (Shakes head negatively.)

20 Q. Does any other party use the clay and shale in manufacturing of any items that you know of?

A. I don't understand your question.

21 Q. Now you have testified that you uncovered clay and shale in the process of strip mining coal.

A. That is not true.

22 Q. All right. You have stated before, I believe, [fol. 203] that you do uncover clay and shale as a part of your process.

A. Yes, sir.

23 Q. And I have asked if that material, clay and shale, is ever used in the manufacturing of any product in this area.

A. I still don't understand your question. In the coal operation, no.

24 Q. Do you know if they manufacture any brick or tile or sewer pipe in this area?

A. Not from any clay that came from the coal.

25 Q. Did any—Do you know if they ever manufacture these items in this area?

A. Yes, I know that there is brick made and tile manufactured.

26 Q. And do you know that this is made out of clay and shale?

A. Yes, sir.

27 Q. Now, the clay and shale which is used, does it come from lands that is yours or was formerly yours?

A. It was originally mine, yes, sir.

28 Q. And how does the clay and shale get to the manufacturer?

A. Different ways. Some of the manufacturers haul it theirself, and in some instances we deliver.

29 Q. Do they dig their own clay from the lands?

A. Repeat that.

30 Q. Do they dig or mine the clay from the land?

Mr. Travis: Just a minute. May I have the record state as to whether your questions are directed to the year 1951?

Mr. Friesen: My questions are directed to the general process. I am laying the foundation before the questions, which I shall ask specifically about specific years. To prevent leading the witness and his answers, I'm asking him generally about what he knows.

[fol. 204] Mr. Travis: Well, I want the record to show a general objection by the plaintiff to any questions regarding the operations of L. R. Chapman, questions regarding mining clay or shale from lands owned by L. R. Chapman, Inc., other than those existing in the year 1951, which is the only year involved in the cause of action before us."

The Court: You are objecting to the question?

Mr. Travis: (For Pltf.) Yes, I think the objection should apply to Question 30, which is: Do they dig or mine the clay? supplemented by "And by 'they' I'm referring to the people who used the material" for the reason that

the question is not limited to the year involved in this suit, being 1951.

The Court: You say you follow it up later on?

Mr. Friesen: (For Deft.) Your Honor, I ask about some other years, but related to the year, '51, the evidence is in the record as to that year.

Mr. Travis: (For Pltf.) Later, your Honor, for instance, we get down to the Question 39, which is just eight questions long, and the question then gets specifically directed to '49 and '50; so, this is not particularly laying the ground work for 1951 in any sense of the word.

Mr. Friesen: (For Deft.) I was attempting to explain or get into evidence a continuing market; not a market which occurred at one specific time and one specific year. A market is not something which comes in and out of existence. And I submit it is relevant as to whether there was a market in '49, '50, '51, '52, and '53.

The Court: All right. Overruled. You may answer the question.

A. They pay me to do it.

32 Q. Do the users of the clay or shale always pay you to do it?

[fol. 205] A. Yes, sir.

33 Q. They do not mine it themselves?

A. Not of my knowledge.

34 Q. You have stated that the land was formerly owned by you. Would you explain what you mean by 'formerly owned by you'?

A. Well, at one time I owned it. I had a deed of general warranty for it.

35 Q. And you sold the land to the users, is that correct?

A. Some of it.

36 Q. And what have you done with the other land?

A. It's still mine.

37 Q. And from that land that is still yours, you are selling shale and clay to the users?

A. No, sir.

38 Q. Well, what is the arrangement by which you deliver the shale and clay to these people?

A. With a mining contract.

39 Q. Now, do you have a—(To the reporter) Strike that.

During the year, 1949, 1950, did you mine and deliver clay and shale to any ceramic producer in the area?

A. Yes.

Mr. Travis: To which the plaintiff objects for the reason the years asked in the question are not involved in the cause of action now before us."

Mr. Travis: (For Pltf.) The plaintiff would like to renew its objection to the specific question related to the years prior to the enactment of the law under which the claim for refund is based.

The Court: Overruled.

40 Q. "To whom did you deliver?

A. The Owensboro Sewer Pipe Company.

41 Q. Do you have in your office the records of the [fol. 206] volume and charges which you made against the Owensboro Sewer Pipe Company for those years?

A. Yes.

42 Q. Would you produce those records?

A. Miss Gabbert, would you bring the records for the Owensboro Sewer Pipe Company. (To Mr. Friesen) Of what year?

43 Q. '49 and '50. I will be asking about '52, also.

Mr. Travis: Plaintiff renews its objection to the question for the same reason."

The Court: Overruled.

44 Q. "Now during the year 1951 did you sell any material to Owensboro?

Mr. Travis: Just a minute. I object to the question for the reason the witness has already stated that he did not sell the material.

Mr. Friesen: (To Mr. Travis) You have indicated what answer you wanted, Mr. Travis.

45 Q. During the year 1951, did you deliver any clay and shale to the Owensboro Sewer Pipe Company?

A. Yes, sir.

46 Q. Well, then, with the records for 1949—'50, we'd also like you to produce those for '51.

(Whereupon, Mr. Chapman is Handed Documents by Miss Gabbert)

A. This is 49. (Handing documents to Mr. Friesen).

47 Q. Now, have you stated that you did not own this land at this time?

A. I did not own the land at that time.

48 Q. And who did own the title to the land?

A. The Owensboro Sewer Pipe.

49 Q. Do you know if they still have title to this land?

[fol. 207] A. They do.

50 Q. Are they still taking clay and shale from that land?

A. No.

51 Q. Do you recall, or do you have a record of how much they paid for the land from which this clay and shale was taken?

A. Fifty dollars for the five acres on this first contract.

52 Q. Now, were there subsequent contracts?

A. Well, there was a deed.

53. Q. And how much land was conveyed by that later deed?

A. Three-tenths of 95 acres.

54 Q. Is that an undivided interest in three-tenths of 95 acres?

A. Yes, sir.

55 Q. Who retained the rest of the interest?

A. The Owensboro Brick Company, the Boonville Brick Company, and the Rockport Brick Company, and myself.

56 Q. You owned an undivided interest also in this land?

A. Yes, sir.

57 Q. And do you recall how much Owensboro paid to you for that subsequent transfer?

A. One dollar.

58 Q. For three-tenths of 95 acres?

A. No. Owensboro Sewer Pipe—yes. One Dollar for—that was One Dollar and other valuable consideration.

59 Q. And do you recall what the other valuable consideration was?

A. Yes, sir.

60 Q. What was that?

[fol. 208] An operating contract to mine clay and deliver.

61 Q. And this contract to mine and deliver was a part of your agreement by which you transferred legal title to the land, is that correct?

A. Yes, sir.

62 Q. Now, Mr. Chapman, I hand you what has been delivered to me by your secretary under the heading of "L. R. Chapman, Inc., "At Lewisport, Kentucky," and dated December 1, 1949, and ask if that is your record of deliveries to the Owensboro Sewer Pipe Company?

A. Yes, sir.

Mr. Friesen: (To the reporter) Off the record.

(Off the Record Discussion)

63 Q. I'd like to have this marked as Government Exhibit 1.

(Whereupon, Document Received and Marked by the Reporter as Government Exhibit No. 1)"

(The defendant, for purposes of identification, handed the reporter the document previously marked Government Exhibit I for identification, said document being re-identified as Government's Exhibit I.)

Mr. Friesen: (For Deft.) The Government's Exhibit I, consisting of two pages, was marked by the reporter.

The Court: Any objection to I?

Mr. Travis: (For Pltf.) It has not been offered, but I will have an objection to '49.

64 Q. "Let the record disclose that the formerly described paper was marked Government Exhibit I for identification. I'm handing you Government Exhibit I, Mr. Chapman. Would you explain whether or not all of these [fol. 269] tonnages appearing in the left-hand column under title "Tons," were delivered to the Owensboro Sewer Pipe Company during that year?

A. Yes, they were.

65 Q. And they were delivered from the land that you have described earlier, is that correct?

A. Yes, sir.

66 Q. And the amounts under the column showing at 4.25 per ton . . .

A. (Interposing) That's coal.

Mr. Travis: Now, don't mix up coal.

67 Q. I'm sorry. Under the column at 1.40 Dollars per ton, were deliveries of clay and shale made during the year 1949?

A. Yes, sir; that's what they paid us for our services.

68 Q. And they paid you this plus $1.00 for the transfer of title to property, is that correct?

A. That was off their own property, the five acres, that was sold for $50.00.

69 Q. So that this figure of $862.93 was what they paid you in addition to the $50.00?

A. Yes, sir.

70 Q. Which was transferred—given to you for transfer of title?

A. (Nods head affirmatively).

71 Q. And was this coal also from that same land?

A. No, sir.

72 Q. I'll ask the reporter to mark this document bearing the date February 1, 1950, as the Government's Exhibit No. II.

(Whereupon, Document Received and Marked by the Reporter as Government Exhibit No. II)"

(The defendant, for purposes of identification, handed the reporter the document previously marked Government Exhibit II for identification, said document being re-identified as Government's Exhibit J.)

[fol. 210] 73 Q. "Mr. Chapman, I hand you what has been marked for identification Government Exhibit II, and ask if these amounts appearing on the column, "Number of pounds," opposite clay invoices, is the number of pounds of clay that you sold to the Owensboro Sewer Pipe Company during the period covered by that document?

A. That's the number of pounds that I delivered to them, yes, sir.

74 Q. And it was under the same arrangement as the other deliveries, as far as payment and purchase?

A. Yes, sir.

Mr. Friesen: (To the reporter) Off the record.

(Off the Record Discussion)

75 Q. The reporter will mark this the Government's Exhibit III for identification, please.

(Whereupon, Document Received and Marked by the Reporter as Government Exhibit No. III)"

Mr. Friesen: (For Deft.) Government's Exhibits 3 and 4 were marked at the time and not offered.

76 Q. "Mr. Chapman, I ask you, or, hand you what has been marked for identification Government Exhibit No. III and ask you if this is the document you have shown us applicable to the year 1951.

A. Yes, sir.

77 Q. Now, have you sold or delivered these—the amounts shown on each of these pages to the Owensboro Sewer Pipe Company from the land transferred as you have previously described?

Mr. Travis: I object to the question unless you are specific about what land you are talking about. There are two parcels involved here.

78 Q. From which of the two parcels was this delivered, Mr. Chapman?

[fol. 211] A. Parcel one.

79 Q. Which is the . . .

Mr. Travis: (Interposing) Five acres.

80 Q. . . . five acres . . .

A. (Interposing) Five-acre tract.

81 Q. Transferred for $50.00?

A. Yes.

82 Q. Now, during the month of June, 1951, what amount of clay was delivered to Owensboro?

A. 532.71 tons.

83 Q. And how much did you charge for this delivery of clay and shale?

A. For stripping and loading and hauling, delivering, I charged them a Dollar and Forty Cents.

84 Q. And what was the total amount?

A. $745.79.

85 Q. And for the month of July, 1951, will you give us the total tonnage and total cost, please?

A. 1,023.52 tons, and for our services that we charged $1.40.

86 Q. Per ton?
A. Per ton.
87 Q. And at a total . . .
A. $1,432.93.
88 Q. And during the month of August, 1951?
A. There was 1,017.26 tons, the same as was last month for services, such as mining and hauling and delivering, $1,424.16.
89 Q. And during the month of September?
A. 1230.16 tons. For our services they paid us a Dollar Forty cents.
90 Q. Per ton, for a total——
A. (Interposing) Per ton, for $1,722.22.
91 Q. And during the month of October, 1951, Mr. Chapman?
[fol. 212] A. 1295.03 tons.
92 Q. Just the total figure will be fine.
A. $1,813.04.
93 Q. And during the month of November, Mr. Chapman?
A. 1506.94 tons, for $2109.71.
94 Q. And during the month of December, the tonnage and the price?
A. $1618.46, for $2265.48.
95 Q. You meant the first figure as tons?
A. Yes.

Mr. Travis: Instead of dollars.

96 Q. That was 1618.46 tons at 2265.48 Dollars?
A. Right.
97 Q. Mr. Chapman, you have given us the figures off of Government Exhibit No. 3, so I return this for your files. Now, do you also have figures such as this for the year 1952?
A. Yes, we do have.
98 Q. Would you, while you are at it, get out the years '52 and '53, please.
A. '52 and '53?
99 Q. Yes, please.
A. Yes, sir.
100 Q. All right.

(Whereupon, the Witness was Handed Documents by Miss Gabbert)

101 Q. Referring back to the Government's Exhibit 3, were the figures you have given us taken from the books and records of the L. R. Chapman, Inc.?

A. Yes, sir.

102 Q. And you believe them to be accurate figures, is that correct?

A. Yes.

[fol. 213] 103 Q. And they were kept in the ordinary course of the business of the L. R. Chapman, Inc.?

A. Yes, sir.

104 Q. May I see what the secretary has handed you for the year 1952?

A. Yes, sir.

(The Witness Hands Documents to Mr. Friesen)

105 Q. Now, Mr. Chapman, I am handing to the reporter what has been marked 1952 on the front to be marked Government Exhibit 4.

(Whereupon, Document Received and Marked by the Reporter as Government Exhibit No. 4)

106 Q. Mr. Chapman, is this Government Exhibit 4 a record which has been kept in the ordinary course of your business?

A. Yes, sir.

107 Q. Now, would you proceed through there, starting with January, and just read for each month the total tonnage sold and the price at which it was sold or delivered, understanding that I'm talking about the amount that you charged the customer for whatever you did?

A. I can give you the contract price.

Mr. Travis: To which the plaintiff objects for the reason that any figures concerning the year 1952 are not pertinent to any issue in the cause of action before us."

The Court: Well, I will overrule it.

108 Q. "Would you go ahead and read those figures Mr. Chapman? If you will, just start at the back and flip the pages forward, I think, is the total figures you will find. I think that's (indicating) for January.

[fol. 214] A. January 31, '52, 1508.86 tons, $2112.40. Here is one we had a mechanical error for February 29, 1952, 1420.53 tons, $1988.74. That is corrected.

109 Q. All right.

A. March 31, '52, 1835.70 tons, $2569.98. Through April 30, 1295.28 tons, for a total dollars of $1813.39. This is through May 31, '52, 1020.48 tons, for a total of $1632.77. This is ending June 30, 1952, 2515.17 tons, for $4024.27. Through June 31, 1952——

Mr. Travis: (Interrupting) Isn't that July? Didn't you just give June?

A. This is July, I meant to say. Through July 31, 1952, 987.93 tons for $1580.69. Through August 31, 1952, 1543.93 tons for a total of $2470.29. There is a mechanical error at the office, we made a mistake of four and a quarter where the price is different.

110 Q. But the figure which you have given us is correct?

A. Yes, this figure here, I'm sure, is correct.

111 Q. All right.

A. This is through September 30, 1952, 2228.03 tons for $3564.85. This is through October 31, 1952, 1571.87 tons for a total of $2514.99. Through November 30, 1952, 1604.45 tons for $2567.12. Through December 31, 1952, 1702.59 tons, for $2724.14.

112 Q. Now, from what land were you taking that clay and shale during the year 1952?

A. Still from the first tract, the five-acre tract.

113 Q. Was there any distinction made between the clay and shale that was taken? Was it intermixed, or was it mined separately?

A. I don't—can't answer that. I don't know. We mined it the way they told us. I didn't know clay from shale. I don't yet.

114 Q. In your invoice you listed the clay and shale. [fol. 215] Who made that entry on these earlier 1949 invoice records, Government Exhibit 1?

A. That's what they told us they was taking, clay and shale.

115 Q. You say that you don't know the difference between clay and shale?

A. No, sir.

116 Q. Mr. Chapman, to what, or, for what other producers of brick and tile have you mined and delivered clay——

Mr. Travis: (Interrupting) Just a minute.

117 Q. (Continuing)—and shale?

Mr. Travis: Plaintiff objects to the question, unless it's limited as to time."

The Court: Read that question.

(Mr. Friesen read Questions Nos. 116 and 117 to the Court at this time.)

The Court: Overruled. You may answer.

118 Q. "Please answer my question. For what other producers of brick and tile products have you mined and delivered clay?

A. Oh, for what period are you asking me about?

119 Q. During the course of your business of delivering and mining clay and shale.

A. Up to now?

120 Q. Yes, sir.

A. The Owensboro Sewer Pipe, the Murray Tile Company, Owensboro Brick, Rockport Brick, Boonville Brick, and Cannelton Sewer Pipe.

121 Q. During the year, 1951, were you delivering to any other producer of brick and tile?

A. Not to my knowledge.

[fol. 216] 122. Q. When did you start selling or delivering and mining for Rockport Brick?

A. I——

Mr. Travis: (Interrupting) Just a minute. To which the plaintiff objects for the reason that it could not involve the year 1951, since the witness has already testified he delivered only for Owensboro Sewer Pipe Company during that year."

The Court: Overruled. You may answer.

123 Q. "Will you answer the question?

A. I can't tell you without checking.

124 Q. Would you check, please?

A. Miss Gabbert, will you get me the first invoice on Owensboro Sewer Pipes?

125 Q. Rockport.

A. I mean, Rockport.

126 Q. (To Miss Gabbert) You might look up the same as far as Boonville Brick and Murray Tile, and Cannelton Sewer.

(Whereupon, the Witness is Handed Documents by Miss Gabb*ard*)

A. From my records, Boonville Brick received their first clay on September—in September, 1954.

Let me check these, first. (Witness examining records.) According to my records, the first work we did for Rockport Brick and Tile was in the month of January 1956.

127 Q. All right. And for Murray?

A. Murray Tile Company, according to my records is December 2nd—no, pardon me, November 30, 1952.

128 Q. And with—was it clay and shale which was mined and delivered by you for each of these organizations that [fol. 217] you have named taken from land which has once been owned by you?

A. Yes.

Mr. Travis: To which the plaintiff objects because the question relates solely for years other than 1951."

Mr. Travis: (For Pltf.) There was the same objection, your Honor.

The Court: Overruled.

129 Q. "Your answer to that question was, yes, Mr. Chapman?

A. Yes, sir.

130 Q. And what was the consideration for the lease or sale of the land to these separate companies, if you know?

A. All——

Mr. Travis: (Interrupting) Renew the same objection."

The Court: Same ruling.

131 Q. "Well, take the Murray Brick Comany in 1952.

A. They purchased——

Mr. Travis: (Interruption) Which company is this?

Mr. Friesen: (To Mr. Travis) Murray.

A. They purchased, the best I can remember, it was fourteen acres. It was a rental purchase, which they could

either pay a five-cent royalty, or buy for a fixed sum of money.

132 Q. And what did they choose to do?

A. Pay a royalty.

133 Q. Five-cent royalty?

A. Yes, sir.

134 Q. Did you also obtain a contract at that time to mine and deliver clay and shale?

[fol. 218] A. At the beginning it was verbal, but—yes, there was a contract to produce. We had one.

135 Q. You had a contract to produce?

A. Yes.

136 Q. Without examining your records, Mr. Chapman, do you know approximately how much clay and shale you produced for—in any given year, say in 1953?

Mr. Travis: To which the plaintiff objects for the same reason."

The Court: There will be the same ruling. You may answer.

A. "I would have no idea without——

137 Q. (Interrupting) Mr. Stafford totaled several of the documents which you handed us, 1950 through 1954-55, when he was in your office earlier, and to the Owensboro Sewer Pipe Company for 1953——

Mr. Travis: (Interrupting) You've got that in——

138 Q. (Continuing)— he had the figure, 19,384.75 tons at a Dollar-Sixty a ton for a total of $31,015.58. Do you know if that figure is correct?

A. I do not. It should be.

139 Q. Mr. Travis, rather than going through and putting these on month by month and totaling them up later, would you concede or stipulate that these are the figures which Mr. Stafford totaled from these papers?

Mr. Travis: What year are you talking about?

Mr. Friesen: For 1953.

Mr. Travis: Yes; he's already got the figures in anyway, whatever the total is.

Mr. Friesen: Not for '53; '52 is the last year we read, I believe.

Mr. Travis: Oh, you didn't read '53?

Mr. Friesen: I thought I'd save some time.

[fol. 219] Mr. Travis: I will stipulate Mr. Stafford's totals, with the objection as to the admissibility.

140 Q. Now, you have testified——

Mr. Travis: (Interrupting) Did you give them in the record?

Mr. Friesen: I think I read them.

Mr. Travis: Oh, did you read that?

Mr. Friesen: Yes.

Mr. Travis: Okay.

141 Q. Mr. Chapman, you have testified that you might have delivered clay and shale to the Cannelton Sewer Pipe Company who is the plaintiff in this suit. Do you recall when you first delivered to them?

A. Yeah.

142 Q. When was that?

A. I couldn't—I don't know if I can remember the exact date, but they was some tests loads that started in the fall of '56.

143 Q. So it was in the fall of '56, or later, that you started delivering clay and shale to them, is that correct?

A. Well, the first we delivered to my recollection was just for test purposes. It would just be a load now and maybe another week another load, just—some of it was just taken in sacks, and so forth. That started in the fall of '56.

144 Q. Well, when did you start delivering to them regularly?

A. On about January 17, '57.

145 Q. Now, have you delivered to them relatively continuously since that time?

A. Yes, sir.

146 Q. Do you have a record of how much you have delivered to them since January of '57?

A. It isn't totaled up.

[fol. 220] 147 Q. Do you have a record to show by month, the totals?

A. When—they—we keep it by week.

148 Q. Well, could you produce that, please?

A. Miss Gabbert, would you find me Cannelton Sewer Pipe?

Mr. Friesen: (To the reporter) Off the record.

(Off the Record Discussion)

Mr. Friesen: Counsel for the plaintiff and defendant stipulated that since January, of 1957, the plaintiff has obtained all of its supply of clay and shale from the mining and delivery of L. R. Chapman, Inc.

149 Q. Mr. Chapman, how far from the other deposits which you have mined and delivered for Owensboro is the present deposit which you mine and deliver from Cannelton?

A. Do you want that in the nearest way, or roadway?

150 Q. Well, possibly—actually, as the crow flies would be fine.

A. Mile and a half.

151 Q. Has Cannelton obtained an interest in this land which you are mining and delivering from?

A. Well,——

Mr. Travis: (Interrupting) I want to object to all these questions that are related to the year 1957, without repeating the objection.

Mr. Friesen: All right. I understand that you have a continuing objection against any year except——

Mr. Travis: (Interrupting) Other than 1951.

Mr. Friesen: (Continuing) —except 1951."

The Court: Well, I will overrule it. You may answer.

A. "I don't understand your question.

[fol. 221] 152 Q. Do they have a lease, or have you transferred the title in this land?

A. Yes, sir; they have a lease.

153 Q. And what was the consideration for the lease, if you recall?

A. There was One Dollar, if I remember, plus a Ten-Cent royalty.

154 Q. Did you also get a contract to mine and deliver?

A. Yes, I do at this time.

155 Q. Mr. Chapman, I believe you stated that the clay and shale which you mine and deliver is not a result of your strip mining of coal for profit.

A. It is not.

156 Q. Who developed this particular land in the sense of examining it to determine whether it had clay and shale in it and preparing it for mining and delivery?

A. The various companies that I do business with.

157 Q. And when you say they did it, did they pay you for doing it, or did they come out and strip off the overburden, and that sort of thing?

A. In some instances they paid me for doing it, like dig a hole where they tell me to and they would take samples. In other instances they did it by core drilling at their own expense.

158 Q. Did you do all of the removal of the over-burden?

A. Yes, by the hour.

159 Q. Did you do the removal of any coal-like deposit that is on top of it, the clay and shale?

A. I don't understand that question.

160 Q. Did you do all of the work in removing the overburden clear down to the clay and shale?

A. In some instances, yes.

[fol. 222] 161 Q. And who did it in other instances, and in which instances are you talking about?

A. Well, in some instances I know of where they have dug in by hand with their own—own help. I know of other times where they had drilled.

162 Q. Now, are you—I'm just talking about preparing it for actual mass production mining. I'm not talking about the investigation work.

A. Well, I did the stripping.

163 Q. Mr. Chapman, you originally stated you were in the business of farming, I believe, and strip mining coal. Would you now add to your business that you are in the business of mining and delivering clay and shale?

A. We don't class it that way. It's—we keep it under the category of contracting. We're in that business now more than——

164 Q. (Interrupting) You are in the contracting business?

A. Yes, sir.

165 Q. And one of the types of contracting you do is strip mining and delivering clay and shale?

A. Yes, we dig ponds, we build roads. We have equip-

ment that we do earth movement work on a contract basis.

166 Q. I have no further questions at this time, Mr. Travis.

Mr. Travis: Do you want to offer any of those exhibits?

Mr. Friesen: Yes. I intend to offer Government Exhibits 1 and 2."

Mr. Friesen: (For Deft.) And which they are now I and J.

(Government's Exhibits I and J were offered in evidence at this time by Mr. Friesen.)

[fol. 223] The Court: Any objection?

"Mr. Travis: To which the plaintiff objects for the reason that said exhibits refer to the years 1949 and 1950 which are not in issue in this case."

The Court: Overruled. I and J are admitted and read, and exhibited in evidence.

(Government's Exhibits I and J are admitted into the evidence, and made a part of the record in this case, said exhibits being in the words and figures following, to-wit:)

(Here Insert.)

Cross-examination.

By Mr. Howard P. Travis:

Mr. Travis: Mr. Chapman, your business is not limited to mining and hauling clay?

Mr. Chapman: No, sir.

167 Q. Do you also haul dirt and other things like that in connection with your contracting business?

A. Yes, sir.

168 Q. You are prepared to haul almost anything that comes out of the earth, are you not?

A. That's right.

169 Q. In reading the figures for 1951 and 1952 of your monthly invoices for hauling clay to the Owensboro Sewer Pipe Company, I will ask you if on each of those invoices

there is not stated at the top a sentence similar to the following:

"List of clay invoices hauled to Owensboro Sewer Pipe Company for the month ending —— by L. R. Chapman, Inc."?

A. Yes, sir.

[fol. 224] 170 Q. Now, are you familiar in general, Mr. Chapman, with the producers in the general area of Lewisport, Kentucky, of brick, sewer pipe, and other vitrified products, clay products?

A. Yes.

171 Q. Is it true that the production of vitrified products in this area of Kentucky is limited to Hancock and Graves counties?

A. I couldn't answer that question; I don't know.

172 Q. Are you familiar with all of the companies in this general area that are producing vitrified products of any kind?

A. Yes, sir.

173 Q. Are the—are those companies limited to the ones which have been talked about in your testimony?

A. I don't know.

174 Q. You don't know whether there is any others producing brick and tile in this area?

A. Not to my knowledge, there isn't.

175 Q. There isn't. During 1951, did you not deliver for, mine for, or sell to,—(To the Reporter) Strike out "sell to" in that question, please—any producer of vitrified products other than Owensboro Sewer Pipe Company?

A. Not to my knowledge.

176 Q. And the other companies to which you have testified, Owensboro Brick, Rockport Brick, Boonville Brick, and Cannelton Sewer Pipe Company, so far as you know during 1951 obtained their clay from sources other than yourself?

A. Not that I know of.

177 Q. Did they get it from you?

A. No.

178 Q. Is the tract of land from which you have been delivering clay to Cannelton Sewer Pipe Company, since January, 1957, completely separated from the tract which

[fol. 225] you have been delivering to these other companies?

A. Yes sir.

179 Q. It's a separate mine and vein entirely, is that so?

A. I can't answer to the vein. But its——

180 Q. (Interrupting) A separate piece of real estate?

A. It's a separate piece of real estate, although it joins on one corner.

181 Q. But it had never been mined before you started delivering for Cannelton?

A. No, sir.

182 Q. Do you know anyone in this area near Lewisport, Kentucky, who mines clay and sells it at a ton price in its raw form?

A. No, sir.

183 Q. Have you sold any clay to any producers of vitrified products?

A. I have not.

184 Q. How long have you owned land in this area of Kentucky?

A. Since—the majority of it, since 1946.

185 Q. And have you lived and operated around here ever since that time?

A. Yes, sir.

186 Q. When Mr. Friesen or myself said words to the effect that you own land, is that you personally or L. R. Chapman, Inc., that owns this land?

A. Both.

187 Q. Both. That's all.

Mr. Friesen: Do you want to wait a moment? She's (indicating Miss Gabbert) digging out an invoice for me, and I just want to look at it.

Mr. Travis: All right.

[fol. 226] Redirect examination.

By Mr. Ernest C. Friesen, Jr.:

Mr. Friesen: Mr. Chapman, you testified that all of the mining took place on land which you had formerly owned or still did have an interest in?

Mr. Chapman: Yes.

188 Q. How long prior to your beginning to mine and deliver for each of these persons did you either transfer title or lease the lands to those individuals?

A. Well, . . .

189 Q. Did it amount to a number of months or years?

A. Now, how's that again?

190 Q. You testified that you once owned all of this land.

A. Yes.

191 Q. And that some of it you still do own an economic, or some kind of an interest in it. You either lease it or you own an undivided interest in it. That implies that there were leases or transfers of some kind. I'm asking how long prior to your starting to mine and deliver did you make these leases or transfers. Was it a number of months or a number of years?

A. In some instances it could be months; some instances it could be just a short time. But they was gentlemen's agreements.

192 Q. What did this gentlemen's agreement consist of?

A. It was a general conversation of our contract.

193 Q. You are stating that you had a contract to lease and to mine and deliver made prior to your commencing mining and delivering, is that correct?

A. I don't understand how—what you mean.

[fol. 227] 194 Q. Do you know what I mean by a lease or transfer, do you not?

A. Yes, sir.

195 Q. I'm simply asking do you—did you make the lease, for instance in the Cannelton case, a month before you started mining and delivering, or a year before you started mining and delivering, or a week before you started mining and delivering?

A. Well, they was several weeks involved in negotiating it.

196 Q. Several weeks?

A. Yes.

197 Q. Not months?

A. Well, it could be as much as two or three months.

198 Q. But it didn't amount to a year?

A. No.

199 Q. Now, would any case that you have stated in which you have mined and delivered from land which you

once owned, that amounted to as much as a year in arranging your mining and delivery?

A. No.

200 Q. Then it was generally one complete transaction, wasn't it?

A. Generally, yes.

201 Q. The sale or lease and the agreement to mine and deliver was one bundle of mutual understandings between you?

A. Yes.

202 Q. It had to be put——

A. (Interrupting) It had to be put together, and after they did—they didn't seem to want to do the prospecting or the sampling until they were sure they could get either a lease or a deed.

203 Q. Would you have sold the land for Ten Dollars an acre if you hadn't gotten a contract with Owensboro to mine and deliver?

[fol. 228] A. Might have.

204 Q. Would you have sold the other tract for one Dollar if you hadn't gotten an agreement to mine and deliver?

A. I doubt so.

205 Q. I have asked the secretary to obtain one or two of the invoices to Owensboro for 1951, and depending on how they come up, I may have another question.

A. What do you mean, invoices?

206 Q. Those list an invoice number, Mr. Chapman. I thought you might still have them.

(Off the Record Discussion)

207 Q. Mr. Chapman, how long have you been testing clay in your own operation here?

A. I have never tested any clay.

208 Q. This furnace that you have here and the pyrometric cone that you have set up opposite the furnace, that is nothing that you have done?

A. That was did by a ceramic engineer.

209 Q. You bought the furnace and had the engineer come in, is that correct?

A. No. He bought the furnace and does it on his own.

210 Q. Does he report to you what he finds?

A. Not necessarily. He tell me once in awhile, which I don't understand what he's talking about, but——

211 Q. (Interrupting) Does he take any clay and shale from your property?

A. Well, not a hundred per cent. He does take clay and shale from there, but he brings it in from everywhere.

212 Q. I don't have any other questions.

Mr. Travis: That's all.

(Witness Excused)"

[fol. 229] Mr. Friesen: (For Defts) Your Honor, I antic ipated closing with that. One thing has been raised by the plaintiff's testimony, the officers of the plaintiff, which I should like to clear up.

It was testified that the future years, or, later years in suit on this issue had been closed by the Government, and the taxpayer; and I use the word "closed" only in the sense they agreed not to go to the Tax Court on the subject at $7.00 a ton. Mr. Stafford is familiar with the way that figure is computed, and I would call him to the stand to explain it.

JOHN C. STAFFORD, a witness called on behalf of the defendant, being first duly sworn, testified as follows:

Direct examination.

Questions By Mr. Friesen:

1 Q. Give the reporter your full name.

A. John C. Stafford.

2Q. And how are you employed?

A. As an engineer with the Internal Revenue Service.

3 Q. And with what office are you connected?

A. Cleveland, Ohio.

4 Q. In the course of your employment in that office, have you had occasion to survey the market in Ohio for the sales of clay?

A. I have made a survey.

5 Q. And in the course of that survey, have you found that underclays of coal are sold in a ground and screened form?

A. I have.

6 Q. Do you know the average price which those sold?

A. These prices vary, depending upon the uses and the extent they are ground, and, too, the conveniences, whether [fol. 230] they are packaged, or shipped, and so forth.

7 Q. Can you give some typical examples of those?

Mr. Travis: (For Pltf.) Mr. Friesen, rather than objecting, because I have no objection to his testifying about Ohio, if it is not going to be used as part of the marketability of Cannelton, Indiana. I don't think that is the purpose of your examination of this witness, but I would like it understood.

Mr. Friesen: (For Deft.) Let me tie it in with this question.

8 Q. (By Mr. Friesen) Do you know if the District Director of Indiana made inquiry of the District Director of Cleveland as to how they were settling or closing the clay cases dealing with sewer pipe?

The Court: Yes or no.

A. Yes, they did.

9 Q. (By Mr. Friesen) Do you know on what basis the Cleveland Office reported to the Indianapolis Office that they were closing or settling these cases?

A. Yes, sir.

10 Q. And what was that report?

A. (Witness referring to memoranda). It was an office memorandum directed to the Appellate Division, of the Cleveland Office, which was in reply to an inquiry from the Appellate Division of the Indianapolis Office, dated October 18, 1955.

11 Q. And what explanation did they give to the office here in Indianapolis?

A. It was stated that the Cleveland Office, the engineering statute was settling cases involving sewer pipe for a value of $7.00 per ton of ground and screened fire clay in accordance with Revenue Ruling 54-109.

12Q. And do you know how the Cleveland Office arrived at that figure of $7.00?

[fol. 231] A. Yes, sir.

13 Q. Was that the result of your survey?

A. Yes.

14 Q. And is it common practice to sell ground and screened fire clay in the Cleveland Area?

A. It is.

15 Q. And what company or companies do you refer to that sold ground and screened fire clay in that area which had a price of around $7.00 per ton.

A. The companies I will mention here, that were used, were actually in the Portsmouth, Ohio Area: the Cambria Clay Products Company, the Oak Hill Fire Brick Company, Pyro Refractories Company, Davis Fire Brick Company, Cedar Heights Clay Company. I have one—That's all.

16 Q. There were actual sales of ground and screened fire clay with the basis of your settlement?

A. That's right.

Mr. Friesen: (For Deft.) I have no further questions.

Cross-examination.

Questions By Mr. Travis:

17 Q. Mr. Stafford, you are aware that other Revenue Districts of the Internal Revenue Service have settled on different prices per ton as the value of fire clay, have they not?

A. Yes.

18 Q. Do you know how high they did go?

A. I don't know except from hearsay.

19 Q. Something over $10.00, wasn't it?

A. I have heard of some.

20 Q. California went something like $26.00, is that right?

A. I don't know as to that.

[fol. 232] 21 Q. I was told, Mr. Stafford, by a gentleman who was in conference with you in your office in Cleveland at one time, about this $7.00 per ton basis, you had indicated a willingness to go as high as $10.00, if you settle cases finally without going to court on them. Is that true?

A. Not exactly. The $10.00 figure you refer to is for a different material. We have values ranging from $4.00 to $10.00, and that was based upon the type of material and the product to be used.

Mr. Travis: (For Pltf.) That's all . . . Just a second. That's all.

Mr. Friesen: (For Deft.) I have no further questions.

(Witness Excused)

COLLOQUY BETWEEN COURT AND COUNSEL.

Mr. Friesen: (For Deft.) I believe, your Honor, that subject to our opportunity to rebut that which may be presented by the plaintiff in the future, that the Government rests its recitation of facts.

The Court: You don't mean to state it exactly that way. Your agreement was you had a right to offer evidence in response, before we get to rebuttal, to this expert witness; then after we finish that, both sides will have their rebuttal.

Mr. Travis: (For Pltf.) Your Honor, may I have a very short conference with my clients before we conclude?

(At This Time the Government, Defendant in This Cause, Rests its Case Subject to Agreement as Made Between Counsel for the Plaintiff and Counsel for the Defendant.)

The Court: We will have a few minutes' recess.

[fol. 233] (Whereupon the Court was recessed at 3:55 p.m., and reconvened at 4:18 p.m., at which time the following proceedings were had:)

Mr. Travis: (For Pltf.) If your Honor please, the plaintiff has, through neglect, failed to identify the two pieces of clay and shale that were exhibited yesterday, and identified by the witness.

(The plaintiff, for purposes of identification, handed the reporter certain objects for marking, and which were by said reporter marked Plaintiff's Exhibits Nos. 19 and 20.)

Mr. Travis: (For Pltf.) The plaintiff now offers in evidence Exhibits No. 19, which is the sample of clay identified by Mr. Eugene Clemens as fire clay, and Plaintiff's Exhibit No. 20, which is the clay identified by the same witness as shale.

(Plaintiff's Exhibits Nos. 19 and 20 were offered in evidence at this time by Mr. Travis.)

Mr. Friesen: (For Deft.) No objection, your Honor.

The Court: There being no objection, 19 and 20, then, are admitted and exhibited in evidence.

(Plaintiff's Exhibits Nos. 19 and 20 are admitted in evidence, and made a part of the record in this case, said exhibits being in the words and figures following, to-wit:)

(Here Insert.)

Mr. Travis: (For Pltf.) The plaintiff now rests its case, and withdraws its request for an opportunity to present Dr. Everhart as a witness.

(At This Time the Plaintiff Rests.)

Mr. Friesen: (For Deft.) Your Honor, I should like to consider the possibility of consulting an expert. I had [fol. 234] counted on Dr. Everhart's being here, and having consulted with him, know somewhat the nature of his testimony. I admit this surprises me, and probably the Government will not want to call him or another expert; but some short reasonable time to consider the problem . . .

The Court: (Interposing) Would you want to recess here and collaborate on the matter a little bit? It is only four-thirty.

Mr. Friesen: (For Deft.) Well

The Court: The Court, too, is surprised.

Mr. Friesen: (For Deft.) Dr. Everhart is a distinguished ceramist, and Dr. Murray is a mineralogist, and the problem of what a refractory or refractor brick is may be relevant to what fire clay is, whether this material is fire clay.

Mr. Travis: (For Pltf.) Your Honor, our reason is I might say, the evidence which we intended to produce from Dr. Everhart is nothing but cumulative of the testimony of Dr. Haydn Murray, an expert, and Mr. Eugene Clemens, another ceramic expert: so we just decided the Court has been advised sufficiently by those two what our position is on the matter, and, as I say, Dr. Everhart's testimony would just add more to the same.

Mr. Friesen: (For Deft.) May I ask the Court if it would like to have briefs summarizing the terms and positions we have taken here?

The Court: Yes. I would be in no position to decide the matter today, even if both sides rest.

Mr. Friesen: (For Deft.) The safe thing for me to say is say I would like to call an expert and withdraw my intention some later time. I feel I need to review my notes more extensively than right now. I would like to see what is in evidence.

The Court: In view of the arrangement that was made, [fol. 235] I assume that it would be taking advantage of you if you could not resolve the matter today.

Mr. Friesen: (For Deft.) I do not intend to right now. The way I feel now I do not think it is necessary, but I would . . .

The Court: (Interposing) Why don't we do it this way: Why don't you rest today in trying the case before the Court, and if you believe, after looking this matter over carefully, that you do need this expert or some expert, that you file a request to re-open the case, and we limit the time. How would that be?

Mr. Friesen: (For Deft.) Under those circumstances the Government rests.

(At This Time the Defendant Rests.)

The Court: All right. And the Court would give you—How much time do you think would be a reasonable time for you to move and re-open the case?

Mr. Friesen: (For Deft.) Within 10 days would be satisfactory.

The Court: Let's see, could you make it quicker than that, without my going into a half-hour's explanation here of my problem?

Mr. Friesen: (For Deft.) I have a case to try Friday in Omaha, and Monday in St. Joe, Missouri.

The Court: This is Wednesday.

Mr. Friesen: (For Deft.) A week from today, sir.

The Court: I say this is Wednesday. I wonder if we could not say five days.

Mr. Friesen: (For Deft.) All right, your Honor.

The Court: I appreciate your cooperation on that, meaning that I will be able to dispose of your case before summer, but 10 days may break my back.

Now, the Court would appreciate the use of the transcript here. Do counsel intend to order transcripts?

[fol. 236] Mr. Travis (For Pltf.) I have ordered about four, I think.

Mr. Friesen: (For Deft.) I ordered a copy. I would be glad to share the cost of the Court's.

The Court: Counsel could proceed now on some of the work on your briefs, I assume.

Mr. Travis: (For Pltf.) I am afraid, your Honor, it will be difficult until we get the transcript.

The Court: How much time do you want to file your brief in support?

Mr. Travis: (For Pltf.) I would like to have 30 days.

Mr. Friesen: (For Deft,) Two weeks after I received a copy of his brief. I can have most of the work done. We write our own briefs.

Mr. Travis: (For Pltf.) I can get it in faster . . .

Mr. Friesen: (Interposing) We are on the road a great deal. If he gets it in in two weeks, I would like to have two weeks after that.

The Court: He is saying 30 days, the plaintiff is. The Court goes on vacation July 1, gentlemen, and it looks like your briefing time will just about run out and everything will be ready for me when I am to go on vacation. The judicial Council insists upon deciding a case 30 days after it is submitted to me. The last geological case, involving oil, turned out to be a summertime project for me.

Mr. Friesen: (For Deft.) May I put it this way: I would like half the time Mr. Travis has.

Mr. Travis: (For Pltf.) I think, Judge, that would be before the end of May at the longest.

The Court: March 31 I leave here, and I have a calendar of 35 cases in Terre Haute, and I lease there and go to Evansville, and I have another calendar of 35 cases; then I go to New Albany. I will be back here the first of June, and we start an income tax fraud case for the remaining three weeks, and that will end up the first of July. I am [fol. 237] just loaded between now and then.

Mr. Travis: (For Pltf.) As I compute it, if I have 30 days from March 24, and he had 15, it would be early in May that the time would run out. . . . Let me shorten it to 21 days.

The Court: You see, after you go to work you are more conversant with your research; I have to do some digging.

Mr. Travis: (For Pltf.) I think a good deal of our briefing work is done.

The Court: We will say three weeks from the date the transcript is filed in the Clerk's Office. And thereafter 10 days, and your reply brief, how long, Howard?

Mr. Travis (For Pltf.) Ten days.

The Court: Then the Court would request you supply findings of fact and conclusions of law on both sides, and an entry you think it might be.

Anything further?

Mr. Travis: (For Pltf.) I believe not.

The Court: If not, we will stand adjourned.

(Whereupon that was all of the proceedings had in the above cause, and the Court was adjourned at 4:25 o'clock p.m.)

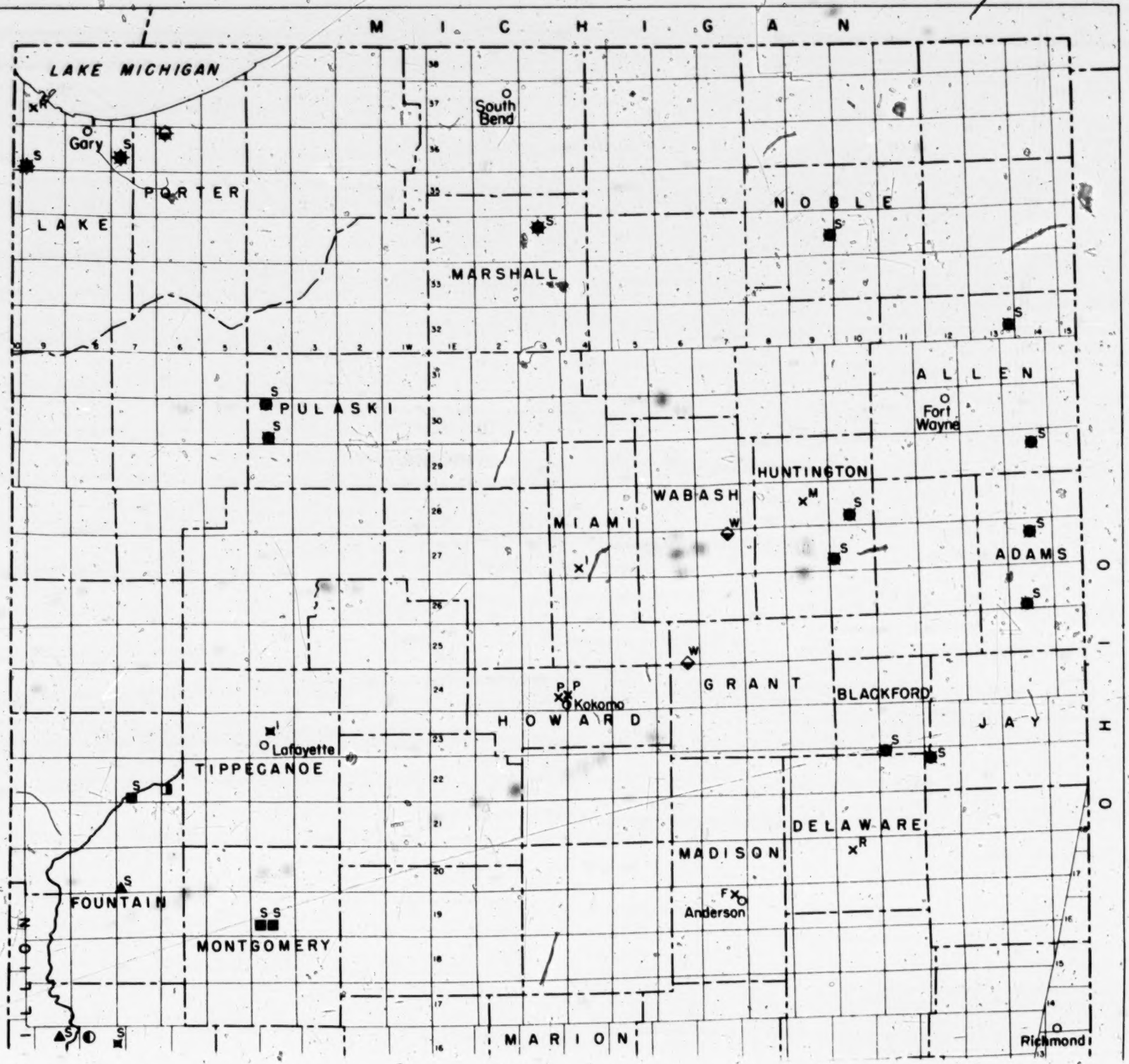
[fol. 238] Reporter's Certificate Omitted in Printing.

INDIANA DEPARTMENT OF CONSERVATION
GEOLOGICAL SURVEY

INDUSTRIAL MINERALS ATLAS MAP NO. 1

EXPLANATION

- Pleistocene clay till pit and ceramic plant
- Pleistocene water-laid clay pit
- Pleistocene water-laid clay pit and ceramic plant
- Pennsylvanian clay pit
- Pennsylvanian clay pit and ceramic plant
- Pennsylvanian shale pit
- Pennsylvanian shale pit and ceramic plant
- Pennsylvanian clay and shale pit
- Pennsylvanian clay and shale pit and ceramic plant
- Mississippian shale pit
- Mississippian shale pit and ceramic plant
- Silurian shale pit
- Ceramic plant
- Ceramic plant not using Indiana materials
- Underground mine
- A Art works
- C Cement
- F Facing tile products
- I Insulator products
- M Modeling clay products
- P Pottery products
- R Refractories
- S Structural products



R Refractories

S Structural products

W Rock wool products

VERMILLION RIVER

PARKE

PUTNAM

MARION

Indianapolis

Richmond

MORGAN

FRANKLIN

Terre Haute

Brazil

CLAY

VIGO

BROWN

Bloomington

GREENE

JACKSON

DAVIESS

MARTIN

Vincennes

WABASH

CLARK

DUBOIS

New Albany

RIVER

WARRICK

VANDER-BURGH

PERRY

SPENCER

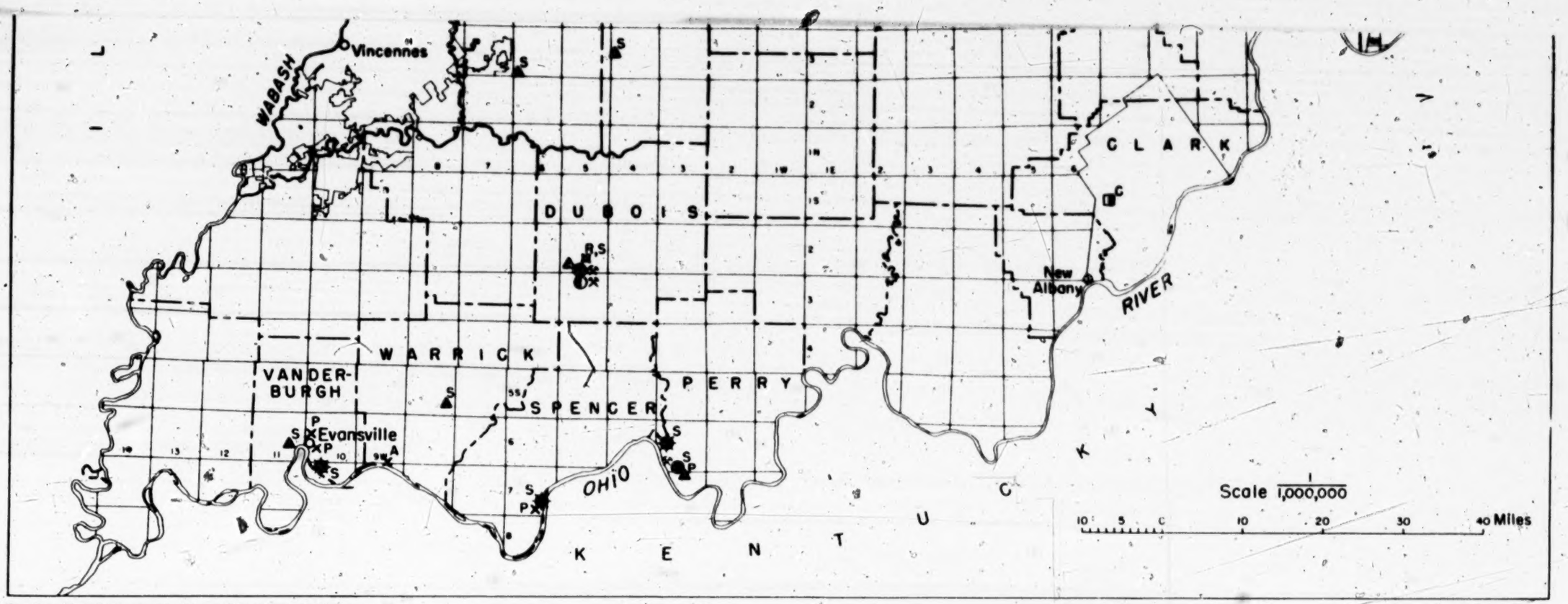
Evansville

OHIO

KENTUCKY

Scale 1/1,000,000

10 5 0 10 20 30 40 Miles



Base from Map of Indiana, 1950 edition, published by U. S. Geological Survey. Minor revisions and additions made from Indiana Department of Conservation, Geological Survey, county base maps.

MAP SHOWING LOCATION OF CLAY AND SHALE PITS AND CERAMIC PLANTS IN INDIANA

Compiled by H. H. Murray
June 1952

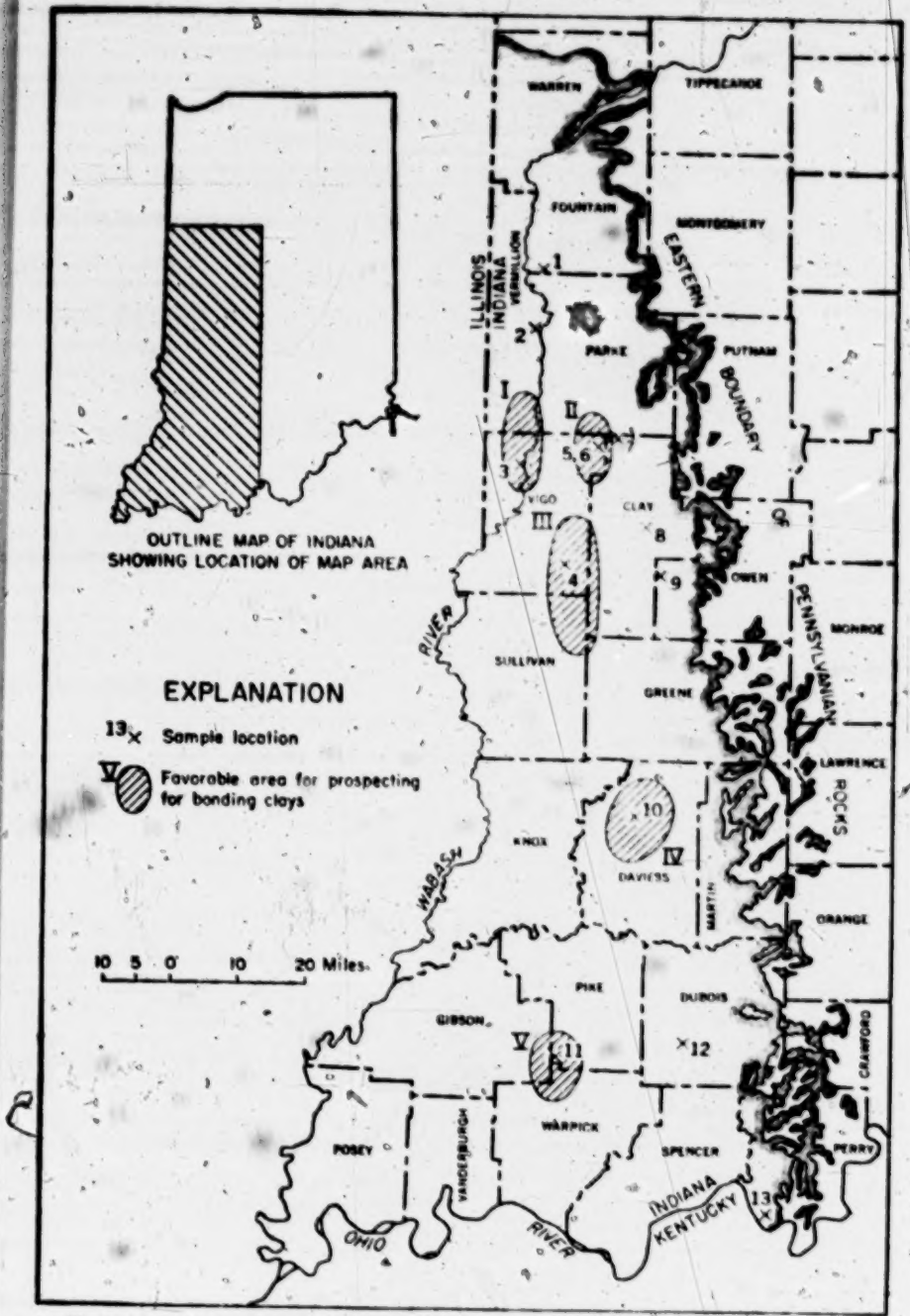


Figure 1. Map of southwestern Indiana showing sample locations, Pennsylvanian bedrock, and five favorable areas for prospecting for bonding clays.

[fol. 241] GOVERNMENT'S EXHIBIT A

Directory of Producers and Consumers of Clay and Shale in Indiana

By Haydn H. Murray

Indiana Department of Conservation
Geological Survey
Directory No. 3

1955

[fol. 242]

STATE OF INDIANA
George N. Craig, Governor

DEPARTMENT OF CONSERVATION
Harley G. Hook, Director

GEOLOGICAL SURVEY
Charles F. Deiss, State Geologist
Bloomington

Directory No. 3

DIRECTORY OF PRODUCERS AND CONSUMERS OF CLAY AND SHALE IN INDIANA

By Haydn H. Murray

Printed by authority of the state of Indiana

BLOOMINGTON, INDIANA

February 1955

For sale by Geological Survey, Indiana Department of Conservation, Bloomington, Indiana
Price $ .25

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John B. Patton, Principal Geologist
Bernice M. Banfill, Administrative Assistant to the State Geologist
Mary Beth Fox, Mineral Statistician

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S. A. Friedman, Geologist
Henry H. Gray, Geologist
Harold C. Hutchison, Geologist

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Charles S. Miller, Instrument Maker
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George R. Ringer, Photographer

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[fol. 248] Directory of Producers and Consumers of Clay and Shale in Indiana

By Haydn H. Murray

Introduction

This directory is a revision of the section on clays and shales in Directory No. 1, Directory of mineral raw materials, exclusive of oil and gas, in Indiana (Callaghan and Ecker, 1948). In Directory No. 1, 30 operations which are no longer active are listed and 32 active operations are not listed. A directory of clays and shales is needed by producers and consumers to aid in evaluating a particular operation. Information concerning production of underclay and shale by coal companies is given in Directory No. 2. Directory of coal producers in Indiana (Wier, 1951). Two earlier publications, the first by Blatchley (1904) and the second by Whitlatch (1933), described the clay industry in Indiana.

In preparing this directory all clay and shale producers and consumers except foundries have been visited personally since 1950. (See plate 1 for a map of Indiana showing the location of producers and consumers of clay and shale.) During 1954, data sheets containing pertinent information about each operation were sent to plants and mines for checking. The author expresses his thanks to the owners, superintendents, and managers for their cooperation in checking and returning the information. Mr. John M. Smith, geologist in the clay mineralogy laboratory of the Indiana Geological Survey, aided in obtaining and checking the data.

Nomenclature and Stratigraphy

In general, clays used commercially in Indiana can be classified under one of three types: (1) underclays, (2) shales, and (3) glacial materials.

Underclays are clays lying immediately beneath coal beds of Pennsylvanian age (fig. 1). Refractory underclays are called fireclays in the ceramic industry. Underclays are fine-grained, gray, dense, plastic, and massive and are

composed essentially of hydrous aluminum silicate minerals.

Most underclays have a higher Al_2O_3 content and a lower Fe_2O_3 content than other ceramic raw materials found in Indiana. Mineralogically underclays contain a relatively high ratio of kaolinite [$(OH)_8Al_4Si_4O_{10}$] to illite [$(OH)_4Ky(Mg_4Mg_2Al_4Fe_4)(Si_{8-y}Al_y)O_{20}$] and chlorite [$(OH)_4(Si.Al)_8(Mg.Fe)_6O_{20}Mg_4Al_2(OH)_{12}$]. Underclays generally are more refractory and fire to a lighter color than shales and glacial clays. The range of temperatures over which most

[fol. 249]

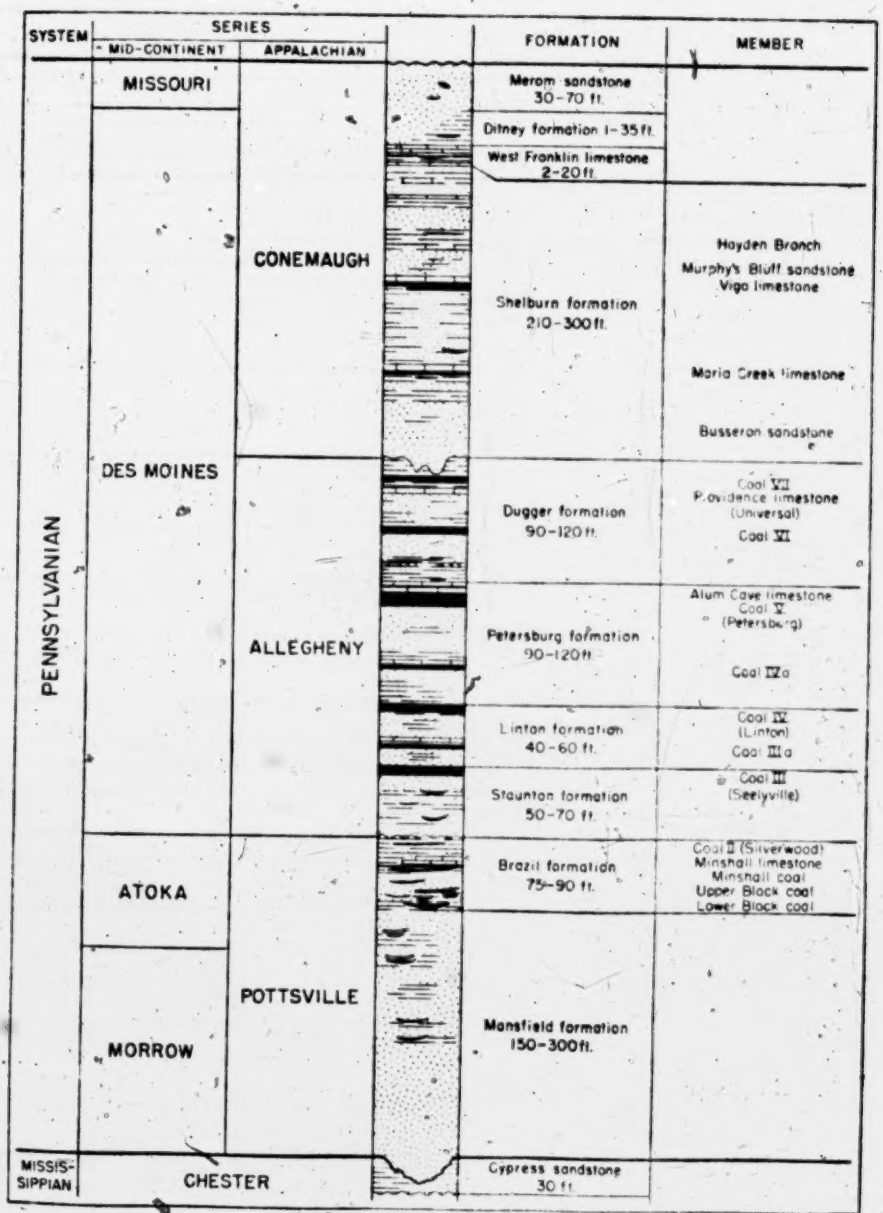


Figure 1. *Generalized stratigraphic column of Pennsylvanian formations in west-central Indiana*

Compiled by C.E. Wier

[fol. 250] underclays vitrify is 100° F. or more.

Shales, fine-grained, earthy materials that have a layered structure, are the most common rock type found on the earth's surface. They are found in association with coals, limestones, and sandstones.

Ratios of SiO_2 to Al_2O_3 and percentages of K_2O and Fe_2O_3 are higher in shales than in underclays. Shales generally contain a relatively high ratio of the minerals illite and chlorite to kaolinite. Most shales burn to a red color and fire at temperatures 100° to 200° F. lower that those of underclays. The range of temperatures over which shales vitrify is 50° to 100° F. Ceramic products are made from shales of Pennsylvanian and Mississippian age (fig. 2).

Glacial materials are the most variable of commercially used clays in Indiana. These materials can be subdivided on the basis of origin into three types: (1) till, (2) lake deposits, and (3) river deposits. Tills are glacial sediments deposited directly by ice, whereas lake and river deposits were laid down by meltwaters from glaciers. Lake sediments were deposited in lakes associated with a glacier, and river muds were deposited by meltwaters flowing down major drainage channels away from the ice.

Glacial clays contain relatively more CaO, MgO, and Na_2O than do underclays and shales, whereas underclays and shales contain more Al_2O_3. Glacial clays contain a relatively low percentage of clay minerals and a high percentage of quartz (SiO_2) and feldspar ($NaAlSi_3O_8$) and a significant amount of calcite ($CaCO_3$) and dolomite ($CaMg(CO_3)_2$). Glacial clays fire at approximately 100° F. below the temperature for shale, and the vitrification range is short, as for most glacial clays it is less than 50° F. The fired color of glacial clays is variable; generally it is some shade of red or tan.

All underclays are Pennsylvanian in age and are restricted geographically to the southwestern part of the state (pl. 1). Ashley (1899, pp. 85-91) divided the "Coal Measures" into nine divisions. Each division except I and IX contained a coal of economic importance. In general, the lower coals (including Coal II) are found in localized basins in only a few areas of Indiana. In contrast, Coals III to VII underlie extensive areas in continuous thick beds. Most underclays have about the same distribution as the coals.

Commercial underclays in Indiana are mined from beneath the Upper Cannelton coal near Cannelton, the Block coals near Brazil, the Minshall coal near Huntingburg, and Coals III and IIIa near Montezuma, Mecca, and Bloomingdale. Only underclays from the Minshall coal and Coal IIIa are used in making refractory brick. Others are the raw materials for structural clay products and, at two locations, for pottery. Still other underclays may become raw materials for manufacturing structural clay products, for bonding clays in foundries, and for other more specialized purposes.

[fol. 251]

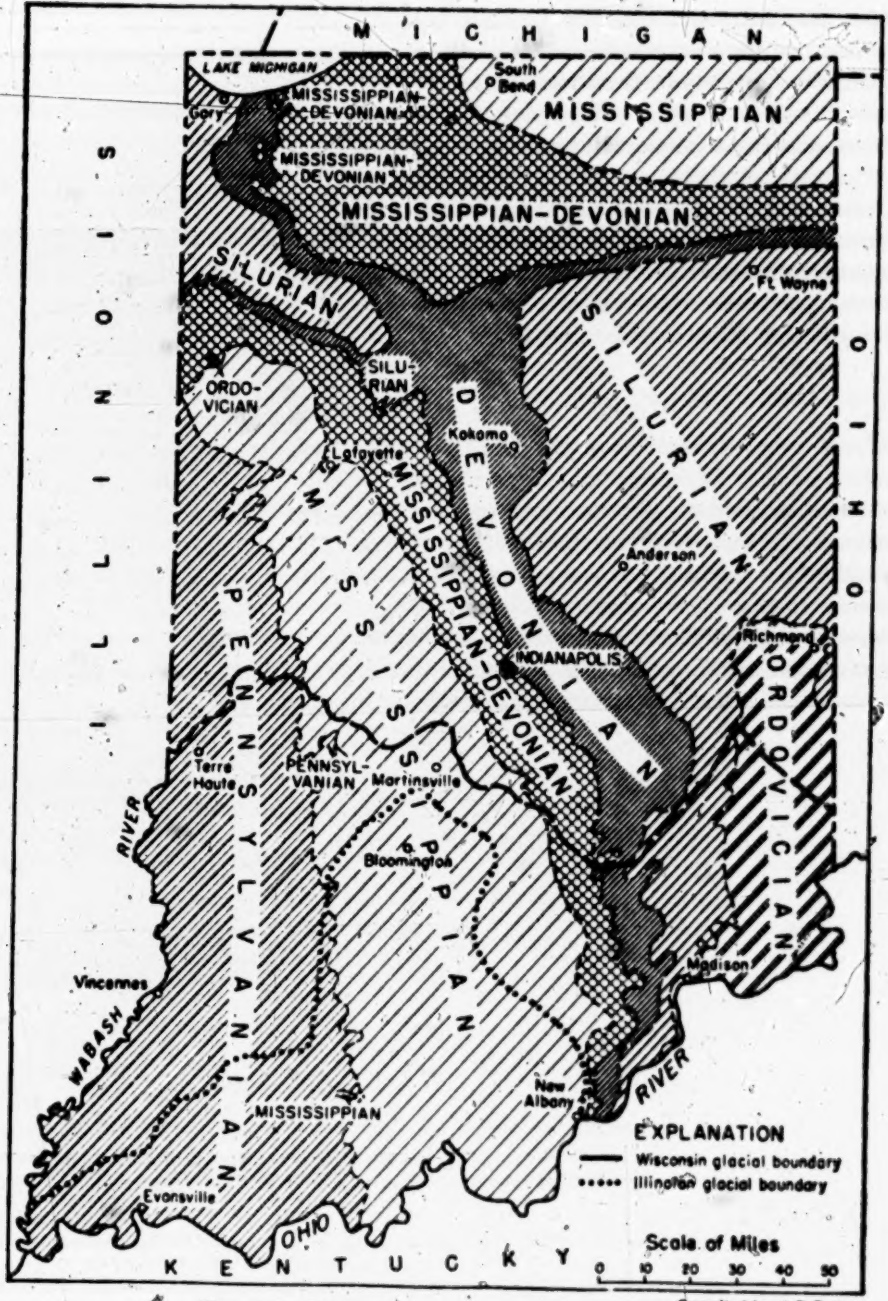


Figure 2. *Generalized bedrock map of Indiana.*

[fol. 252] Shales that are now used commercially in Indiana are Pennsylvanian and early Mississippian in age (figs. 1 and 2). Some Devonian and Silurian shales also were utilized. Eight plants use shale from the Borden formations (early Mississippian) (fig. 2). Shales are present in every Pennsylvanian formation, but only those from the Mansfield, Brazil, Linton, Dugger, and Shelburn formations are used currently (fig. 1).

In making structural clay products Wisconsin tills are used largely in northern Indiana and Wisconsin lake clays in northwestern Indiana. Similar clay products are manufactured from Wisconsin river clays in three plants in the Ohio Valley and from Illinoian till at a plant in Batesville (pl. 1).

Production and Uses

In the latest report of the U. S. Bureau of Mines, 397,336 short tons of underclay valued at $732,025 and 938,956 short tons of shales and glacial clays valued at $968,184 were produced in Indiana in 1952. The total value for clay and shale was $1,700,209. Annual production in tons increased 30 times for underclays and 40 times for shales and glacial clays from 1938 through 1952 (figs. 3 and 4). Most ceramic plants in Indiana reflect this startling expansion in production since World War II.

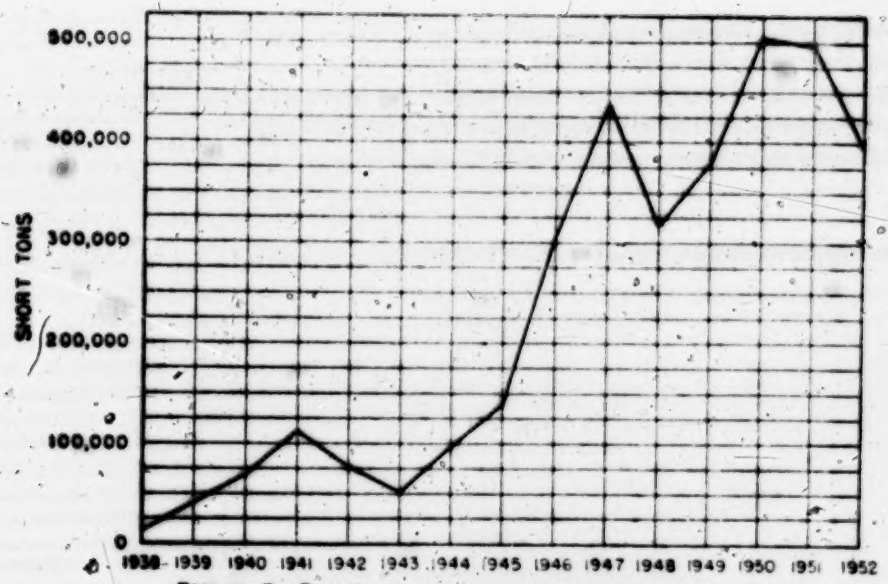


Figure 3. *Graph showing annual production of underclay in Indiana, 1938-1952.*

[fol. 253]

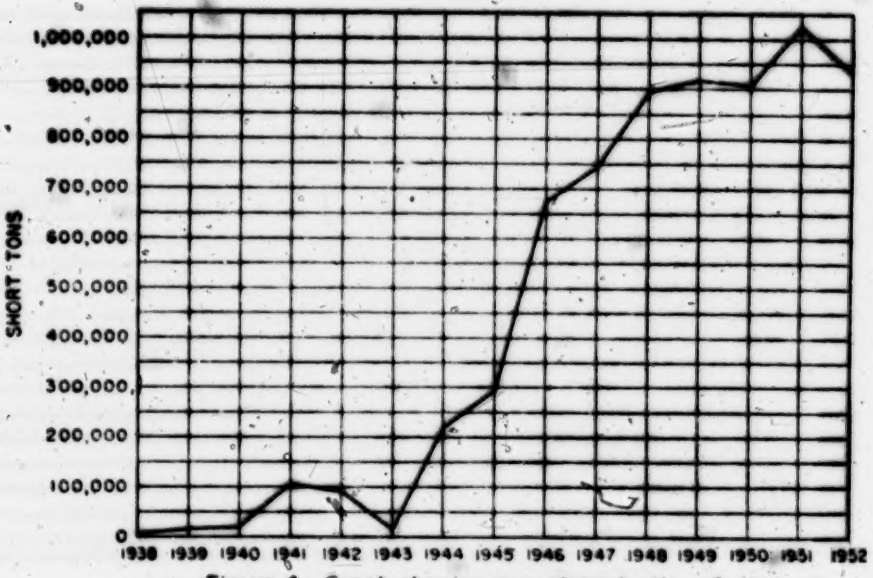


Figure 4. *Graph showing annual production of shale and glacial clay in Indiana, 1938-1952.*

Indiana's clays and shales are manufactured into many products. Any single clay material is not satisfactory for all purposes, as the requirements for some products are specific and limited. Many clays can be used for structural clay products which do not require rigid specifications (see table below).

Raw materials used in making ceramic products in Indiana

Product	Fireclay	Shale	Glacial clay
Refractory brick	X		
Pottery	X		
Cement		X	
Structural tile	X	X	
Farm drain tile	X	X	X
Face brick	X	X	
Back-up brick		X	X
Sewer pipe	X	X	
Flue linings	X		X
Conduit pipe	X		
Paving brick		X	
Insulators	X	X	
Lightweight aggregate		X	

[fol. 254] 1. Adams Clay Products Company
Martinsville
Pit location: Morgan County
Half a mile southwest of Brooklyn on Highway 67
NE1/4SW1/4 sec. 34, T. 13 N., R. 1 E.
Owner: corporation
General manager: James A. Cunningham
Products: face brick
Fired colors: buff and red
Fired temperature: 2150° F. (buff) and 1850° F. (red)
Type of kiln: periodic and continuous
Capacity: 90,000 units daily
Employees: 70
Raw material: Borden shale from captive pit and underclay purchased from Brazil area

2. Albion Tile Company
Albion
Pit location: Noble County
NW1/4SE1/4SE1/4 sec. 24, T. 34 N., R. 9 E.
Owner and general manager: Fred Landgraff
Products: drain tile
Fired color: light red
Fired temperature: 1800° F.
Type of kiln: periodic
Capacity: 15,000 units per year
Employees: 5
Raw material: glacial till

3. American Art Clay Company, Inc.
Speedway City, Marion County
Owner: corporation
General manager: T. O. Philpott
Products: modeling clay, crayons, chalks, and other special art products
Fired color: buff
Fired temperature: 1900° to 2381° F.
Type of kiln: periodic
Employees: 200
Raw material: Minshall underclay purchased from Huntingburg and imported domestic clays

[fol. 245] 4. American Radiator and Standard Corporation
Kokomo, Howard County
Owner: corporation
General manager: V. S. Schory
Products: tanks, bowls, lavatories, and urinals
Fired colors: white and seven colors
Fired temperature: 2200° F.
Type of kiln: continuous
Capacity: 1,200 pieces per day
Employees: 289
Raw material: imported domestic and foreign clays

5. American Vitrified Products Company
Brazil, Clay County
Owner: corporation
General manager: Charles Wilson
Products: sewer pipe, flue liners, and glazed drain tile
Fired color: tan
Fired temperature: 2050° to 2100° F.
Type of kiln: periodic
Capacity: 3,000 tons per month
Employees: [illegible]
Raw material: Upper Brazil Block underclay and Borden shale from Crawfordsville.

6. Arketex Ceramic Corporation
Brazil, Clay County
Pit location: Vermillion County
2 miles south of Newport
SE1/4SE1/4 sec. 10, T. 16 N., R. 9 W.
Pit manager: J. Britton
Employees: 6
Capacity: 125 tons per day
Raw material: underclay of Coal IIIa

7. Arketex Ceramic Corporation Plant No. 2
Brazil, Clay County
Owner: corporation; John Stelle, Chairman of the Board
John A. Stelle, President
Production manager: Ralph Weston
Ceramist: Ross Evans

Products: ceramic glazed structural tile
Fired color: buff
Fired temperature: 2040° F.
Type of kiln: continuous
Capacity: 260 tons per day
[fol. 256] Employees: 150
Raw material: underclay of Coal IIIa from captive pit and Upper Block underclay purchased from Brazil area

8. Arketex Ceramic Corporation Plant No. 3
Brazil, Clay County
Owner: corporation; John Stelle, Chairman of the Board
John A. Stelle, President
Production manager: Ralph Weston
Ceramist: Ross Evans
Products: ceramic glazed structural tile
Fired color: buff
Fired temperature: 2040° F.
Type of kiln: continuous
Capacity: 350 tons per day
Employees: 300
Raw material: underclay of Coal IIIa from captive pit and Upper Block underclay purchased from Brazil area

9. Arketex Ceramic Corporation Plant No. 4
Brazil, Clay County
Owner: corporation; John Stelle, Chairman of the Board
John A. Stelle, President
Production manager: Ralph Weston
Ceramist: Ross Evans
Products: ceramic glazed structural tile
Fired color: buff
Fired temperature: 2040° F.
Type of kiln: continuous
Capacity: 100 tons per day
Employees: 100
Raw material: underclay of Coal IIIa from captive pit and Upper Block underclay purchased from Brazil area

10. Art Chemical Products, Inc.
Huntington, Huntington County
Owners: G. J. Bippus, W. H. Ball, and W. V. Clipp
General manager: G. J. Bippus

Products: modeling clay
Employees: 18
Raw material: imported domestic clays

11. Ayer-McCarel-Reagen Clay Company
Carbon, Clay County
P. O. address: Brazil
Owner: corporation
[fol. 257] General manager: J. C. Hutchinson
Products: building tile and special tile for sewage disposal plants
Fired color: buff
Fired temperature: 2050° F.
Type of kiln: periodic
Capacity: 100 tons per day
Employees: 38
Raw material: Upper Block underclay purchased from Brazil area

12. Big Bend Collieries
Box 293, Brazil
Pit location: Clay County
Two strip pits near Asherville and Billville
Owner: corporation
General manager: Milton Goodman
Products: clay, coal, and shale
Employees: 150
Capacity: 5,000 to 6,000 tons per month
Raw material: Upper Block underclay and shale

13. Bloomfield Brick Company
Bloomfield
Pit location: Greene County
On east edge of Bloomfield
SE1/4NE1/4 sec. 23, T. 7N., R. 5 W.
Owner: corporation
General manager: H. Sparks
Products: face brick and common brick
Fired color: red
Fired temperature: 1850° F.
Type of kiln: periodic
Capacity: 60,000 units per day
Employees: 50
Raw material: shale from Mansfield formation

14. Bonnville Clay Products, Inc.
Boonville
Pit location: Warrick County
On east edge of Boonville
SE1/4SE1/4 sec. 25, T. 5 S., R. 8 W.
Owner and general manager: John E. Richard
Products: building tile, drain tile, and face brick
Fired color: red
Fired temperature: 2200° F.
Type of kiln: periodic
Capacity: 20,000 units per day
[fol. 258] Employees: 10 to 15
Raw material: shale above Coal V

15. Brazil Clay Company Plant No. 1
Box 331, Brazil, Clay County
Owner: corporation
Leo Girton, President
General manager: George Barnhardt
Products: face brick
Fired colors: buff, gray, tan, and brown
Fired temperature: 1900° F. (average); varies from 1860° to 1960° F.
Type of kiln: periodic
Capacity: 55,000 to 65,000 units per day
Employees: 80
Raw material: Upper Block underclay purchased from Brazil area

16. Brazil Clay Company Plant No. 2
Box 331, Brazil, Clay County
Owner: corporation
Leo Girton, President
General manager: George Barnhardt
Products: face brick
Fired colors: buff, gray, tan, and brown
Fired temperature: 1900° F. (average); varies from 1860° to 1960° F.
Type of kiln: periodic
Capacity: 40,000 to 50,000 units per day
Employees: 40
Raw material: Upper Block underclay purchased from Brazil area

17. Brazil Hollow Brick and Tile Company, Inc.
Brazil, Clay County
Owner: corporation
General manager: John Price
Products: telephone conduit tile
Fired color: buff
Fired temperature: 2000° F.
Type of kiln: periodic
Capacity: 100 tons per day
Employees: 100
Raw material: Upper Block underclay purchased from Brazil area

18. Bremen Clay Products Company
Bremen
Pit location: Marshall County
[fol. 259] 3 miles southwest of Bremen
SE1/4NE1/4 sec. 9, T. 34 N., R. 3 E.
Owners: T. J. Thomas and K. Thomas
General manager: T. J. Thomas
Products: farm drain tile, building tile, and common brick
Fired color: light tan to red
Fired temperature: 1850° F.
Type of kiln: periodic
Capacity: 2 kilns per week
Employees: 6 to 10
Raw material: Pleistocene lake clay

19. Brooklyn Brick Company, Inc.
Brooklyn
Pit location: Morgan County
South edge of Brooklyn
NE1/4NE1/4 sec. 35, T. 13 N., R. 1 E.
Onwer: corporation
General manager: Oliver D. Webb
Products: face and common brick, modular and standard size Roman, Norman and SCR brick
Fired color: red
Fired temperature 1880° F.
Type of kiln: periodic
Capacity: 65,000 units per day
Employees: 60
Raw material: Borden shale

20. Brown Coal Company
R. R. 2, Centerpoint
Pit location: Clay County
2½ miles south of junction of Indiana Highways 46 and 59 NW1/4SW1/4 sec. 32, T. 11 N., R. 6W.
Owner and general manager: William Brown and Son
Products: coal and clay
Employees: 5
Capacity: 700 to 1,500 tons per month
Raw material: Upper Block underclay

21. Cannelton Sewer Pipe Company
Cannelton
Mine location: Perry County
1 mile northeast of Cannelton
SW1/4SE1/4 sec. 3, T. 7S., R. 3W.
Owner: corporation
E. F. Clemens, President
[fol. 260] General manager: E. C. Clemens
Products: sewer pipe, flue linings, wall coping
Fired color: tan
Fired temperature: 2100° F.
Type of kiln: periodic
Capacity: 150 tons per day
Employees: 130
Raw material: Cannelton underclay and shale (Mansfield formation)

22. Cayuga Brick and Tile Corporation
Bloomingdale, Parke County
Pit location: Parke County
NE1/4NE1/4 sec. 9, T. 16 N., R. 8 W.
Manager: Herbert Miller
Employees: 4
Capacity: 50,000 tons per year
Raw material: underclay of Coals III and IIIa

23. Cayuga Brick Corporation
Cayuga
Pit location: Vermillion County
South of Cayuga
NW1/4NE1/4 sec. 7, T. 17 N., R. 9 W.
Owner: corporation
General manager: Ray Koester

Products: brick and tile
Fired colors: red and buff
Fired temperature: 2000° F.
Type of kiln: periodic
Capacity: 85 to 100 tons per day
Employees: 30
Raw material: underclay of Coals III and IIIa purchased near Bloomingdale and shale from Staunton formation from captive pit

24. Clay City Pipe Company
Box 161, Rockville
Pit and plant location: Mecca, Parke County
On south edge of Mecca
NE1/4SE1/4 sec. 20, T. 15 N., R. 8 W.
Owner: corporation
General manager: H. D. Cumings
Superintendent: Paul Insley
Products: sewer pipe
Fired color: tan
Fired temperature: 2100° F.
[fol. 261] Type of kiln: periodic
Capacity: 90 tons per day
Employees: 85
Raw material: underclay of Coals III and IIIa purchased near Bloomingdale and shale above Coal IIIa from captive pit

25. Clay City Pipe Company
Box 127, Montezuma
Pit and plant location: Vermillion County
Half a mile west of Montezuma
SE1/4SE1/4 sec. 27, T. 16 N., R. 9 W.
Owner: corporation
General manager: H. D. Cumings
Superintendent: Paul Insley
Products: fire brick, face brick, flue lining
Fired color: buff
Fired temperature: 2000° F.
Type of kiln: periodic
Capacity: 90 tons per day
Employees: 25
Raw material: underclay of Coal IIIa

26. Clay City Pottery
Clay City, Clay County
Owner and general manager: Lloyd Griffith
Products: flower pots, stoneware, jugs, crocks, bird baths, garden ware, etc.
Fired color: buff
Fired temperature: 2150° to 2180° F.
Type of kiln: periodic
Capacity: 40,000 units per year
Employees: 5
Raw material: Upper Block underclay purchased from Brazil area

27. Crown Potteries Company, Inc.
Evansville, Vanderburgh County
Owner: corporation
General manager: L. A. Lundquist
Products: dinnerware and miscellaneous pieces
Fired color: white
Fired temperature: 2000° F.
Type of kiln: continuous
Capacity: 102,000 units per week
Employees: 190
Raw material: domestic and foreign clays

[fol. 262] 28. Dee Clay Products Company, Inc.
Bloomingdale, Parke County
Owner: corporation
General manager: Herbert Miller
Products: drain tile, sewer pipe, flue linings
Fired colors: red and buff
Fired temperature: 1900° F.
Type of kiln: periodic
Capacity: 50 tons per day
Employees: 50
Raw material: underclay of Coals III and IIIa purchased near Bloomingdale

29. Durham and Heidbrieder Clay Company
Cayuga
Pit location: West Union, Parke County
NW1/4NW1/4 sec. 8, T. 16 N., R. 8 W.
Owners and general managers: Russell Durham and Fred Heidbrieder

Employees: 7
Capacity: 150 tons per day
Raw material: underclay of Coals III and IIIa

30. Engle Studio, Inc.
Newburgh, Warrick County
Owners: Mr. and Mrs. Walter Messich
General manager: Walter Messich
Products: decorative art ware
Fired colors: all colors
Fired temperature: 2000° F.
Type of kiln: periodic
Capacity: 100 units per day
Employees: 9
Raw material: imported domestic clays

31. Francesville Drain Tile Company
Francesville
Pit location: Pulaski County
Half a mile north of Francesville
SE1/4NE1/4 sec. 33, T. 30 N., R. 4 W.
Owner: E. C. Overmyer and Sons
General manager: E. C. Overmyer
Products: drain tile
Fired color: tan
Fired temperature: 1700° F.
Type of kiln: periodic
Capacity: 4,000 tons per year
[fol. 263] Employees: 7
Raw material: Pleistocene till

32. G. and F. Coal Company
Brazil
Pit location: three pits in Clay and Parke Counties
Owner and general manager: Leo Girton
Products: coal, underclay, and shale
Employees: 30
Capacity: 500 tons per day
Raw material: Upper Block underclay and shale

33. Gill Clay Pottery Company
Muncie, Delaware County
Owner: corporation
General manager: John H. Gill

Products: refractory glass pots, lids, and furnace linings
Fired color: buff (glass pots unfired)
Fired temperature: 2400° F.
Type of kiln: periodic
Capacity: 50 pots per month
Employees: 30 to 50
Raw material: imported domestic and foreign clays

34. Hannell Pottery Company
R. R. 2, Chesterton, Porter County
Owners and general managers: Mr. and Mrs. Venol Hannell
Products: pottery
Fired colors: buff, white, and red
Fired temperature: 1800° to 2000° F.
Type of kiln: periodic
Capacity: 25 to 50 units per week
Employees: 2
Raw material: imported domestic clays

35. Harbison-Walker Refractory Company
East Chicago, Lake County
Owner: corporation
General manager: F. M. Hiles
Products: refractory brick
Type of kiln: continuous
Capacity: 300 tons per day
Employees: 200
Raw material: imported ganister

[fol. 264] 36. Huntingburg Brick Company
Huntingburg
Pit and mine location: Dubois County
Half a mile southwest of Huntingburg
NE1/4SE1/4 sec. 33, T. 2 S., R. 5 W.
Owner and general manager: Mrs. G. C. Landgrebe
Products: fire brick, face brick, and common brick
Fired colors: buff and red
Fired temperature: 1960° F. for buff-colored and 1900° F. for red-colored
Type of kiln: periodic
Capacity: 21,000 units per day
Employees: 30

Raw material: underclay of Minshall coal and shale above Minshall coal

37. Hydraulic Press Brick Company
Crawfordsville
Pit location: Montgomery County
Half a mile north of Crawfordsville
NW1/4NW1/4 sec. 29, T. 19 N., R. 4 W.
Owner: corporation
General manager: R. Z. Strouse
Products: brick
Fired colors: buff and red
Fired temperature: 1850° F.
Type of kiln: periodic
Capacity: 60,000 units per day
Employees: 60
Raw material: Borden shale from captive pit and underclay of Coals III and IIIa purchased iin Bloomingdale area

38. Indiana Drain Tile Company
Brooklyn
Pit location: Morgan County
Half a mile south of Brooklyn
NW1/4NW1/4 sec. 36, T. 13 N., R. 1 E.
Owners: J. M. Powell Heirs
General manager: O. E. Powell
Products: building tile, drain tile, back-up tile, and facing tile
Fired color: red
Fired temperature: 1800° F.
Type of kiln: periodic
Capacity: 80 tons per day
Employees: 43
Raw material: Borden shale

[fol. 265] 39. Indiana State Farm
Putnamville
Pit location: Putnam County
1 mile south of State Police Station on U. S. Highway 40
NW1/4SE1/4 sec. 19, T. 13 N., R. 4 W.
Owner: state of Indiana
General manager: R. Cramer

Products: brick
Fired color: red
Fired temperature: 1860° F.
Type of kiln: periodic
Capacity: 35,000 units per day
Employees: 60 to 100
Raw material: shale from Mansfield formation

40. Inman Tile Company
R. R. 4, Hartford City
Pit location: Blackford County
1¾ miles west of Mill Grove
NW1/4SE1/4 sec. 31, T. 23 N., R. 11 E.
Owner and general manager: Neil Inman
Products: farm drain tile and back-up tile
Fired color: light red
Fired temperature: 1750° F.
Type of kiln: periodic
Capacity: 2 kilns per month
Employees: 7
Raw material: glacial till

41. Jackson Brick and Hollow Ware Company
Brownstown
Pit location: Jackson County
Northeast edge of Brownstown
SW1/4NE1/4 sec. 11, T. 5 N., R. 4 E.
Owner: corporation
General manager: James Heller
Products: drain tile, brick, back-up tile, building tile
Fired color: red
Fired temperature: 1800° F.
Type of kiln: periodic
Capacity: 75 tons per day
Employees: 30
Raw material: Borden shale

42. Jones Tile Company
Berne
[fol. 266] Pit location: Adams County
East side of Berne
NE1/4SE1/4 sec. 33, T. 26 N., R. 14 E.
Owner and general manager: Rawley D. Jones

Products: farm drain tile
Fired color: light red
Fired temperature: 1750° F.
Type of kiln: periodic
Capacity: 25 kilns per year
Employees: 5
Raw material: glacial till

43. Kalamazoo Clay Company
Carbon, Clay County
Owner: corporation
General manager: George MacFarland
Products: building tile, silo tile, acid tank tile
Fired colors: brown, buff, and gray
Fired temperature: 2050° to 2100° F.
Type of kiln: periodic
Capacity: 50 tons per day
Employees: 45
Raw material: Upper Block underclay purchased from Brazil area

44. Klopfenstein Tile Company
Grabill
Pit location: Allen County
South edge of Grabill
SE1/4NE1/4 sec. 25, T. 32 N., R. 13 E.
Owner and general manager: Aaron Klopfenstein
Products: farm drain tile
Fired color: light red
Fired temperature: 1750° F.
Type of kiln: periodic
Capacity: 8 kilns per year
Employees: 5
Raw material: glacial till

45. Kokomo Sanitary Pottery Company
Kokomo, Howard County
Owner: corporation.
General manager: Frank Burley
Products: bowls, lavatories, and tanks
Fired color: white
Fired temperature: 2450° F.
Type of kiln: continuous

[fol. 267] Capacity: 1,000 units per day
Employees: 195
Raw material: imported domestic and foreign clays

46. Kretz Brick Company
Washington
Pit location: Daviess County
Half a mile south of Montgomery
NE1/4NW1/4 sec. 35, T. 3 N., R. 6 W.
Owners: E. A. and J. H. Kretz
General manager: E. A. Kretz
Products: drain tile, building tile, brick
Fired colors: buff and red
Fired temperature: 1800° F. (red) and 1900° F. (buff)
Type of kiln: periodic
Capacity: 6,000 units per day
Employees: 13
Raw material: underclay of Coal IVa, shale above Coal IVa, and Illinoian glacial till

47. Krick-Tyndall Company
Decatur
Pit location: Adams County
1 mile southwest of Decatur
NE1/4NE1/4 sec. 9, T. 27 N., R. 14 E.
Owner: corporation
General manager: V. M. Krick
Products: farm drain tile
Fired color: red
Fired temperature: 1900° F.
Type of kiln: periodic
Capacity: 750 tons per week
Employees: 90
Raw material: glacial till

48. Lehigh Cement Company
Mitchell, Lawrence County
Pit location: Jackson County
2½ miles east of Brownstown
SW1/4NW1/4 sec. 6, T. 5 N., R. 5 E.
Owner: corporation
General manager: John Pillman
Capacity: 400 tons of shale per day

Raw material: Borden shale

[fol. 268] 49. Log Cabin Coal Company
316 East Vermont, Brazil
Pit locations: Clay County (one north of Brazil and one east of Asherville)
Owner: corporation
General manager: James Eden
Products: underclay of Upper and Lower Block coal
Capacity: 10,000 tons per month
Employees: 12

50. Lone Star Cement Corporation
Box 482, Greencastle, Putnam County
Owner: corporation
General manager: J. J. Van Alstyne
Capacity: 100 tons per day
Raw material: shale above Upper Block coal purchased in Brazil area

51. Loogootee Clay Products Corporation
Loogootee
Pit location: Martin County
East edge of Loogootee
NW1/4NW1/4 sec. 19, T. 3 N., R. 4 W.
Owner: corporation
General manager: Walter X. Brown
Products: drain tile, building tile, and brick
Fired color: red
Fired temperature: 1900° F.
Type of kiln: periodic
Capacity: 75,000 units per week
Employees: 35
Raw material: shale from Brazil formation

52. Louisville Cement Company
Speed
Pit location: Clark County
3½ miles northwest of Speed
NE1/4 donation 148 (Clark Military Grant)
Owner: corporation
General manager: Arthur Beckel
Capacity: 250 tons per day
Raw material: Borden shale

53. Louisville Pottery Company
Louisville, Ky.
Mine location: Dubois County
Southwest edge of Huntingburg
{fol. 269} NW1/4SE1/4 sec. 4, T. 3 S., R. 5 W.
Owner: corporation
John B. Taylor, President
General manager: Charles Raffert
Products: stoneware
Fired color: buff
Fired temperature: 2250° F.
Type of kiln: periodic and continuous
Capacity: 100 tons per month
Employees: 65
Raw material: underclay of Minshall coal

54. Majenica Tile Company
R.R. 5, Huntington
Pit location: Huntington County
Southeast edge of Majenica
SW1/4NE1/4 sec. 38, T. 27 N., R. 10 E.
Owner and general manager: Joe Mills
Products: farm drain tile
Fired color: light red
Fired temperature: 1700° F.
Type of kiln: periodic
Capacity: 40 kilns per year
Employees: 7
Raw material: glacial till

55. Martin Tile Company
Dunkirk
Pit location: Jay County
SW1/4NW1/4 sec. 8, T. 22 N., R. 12 E.
Owners and general managers: Martin Brothers
Products: farm drain tile, building tile, and brick
Fired color: red
Fired temperature: 1800° F.
Type of kiln: periodic
Capacity: 200 tons per month
Employees: 6
Raw material: glacial till

56. Martinsville Brick Company
Martinsville, Morgan County
Owner: Poston Brick and Concrete Products, Springfield
Illinois
General manager: T. D. Fleming
Products: brick
Fired color: buff
Fired temperature: 1900° F.
[fol. 270] Type of kiln: periodic
Capacity: 50,000 units per day
Employees: 40
Raw material: Upper Block underclay purchased from Bra
zil area

57. Maumee Collieries Company
Terre Haute, Vigo County
Pit location: Owen County
Southwest edge of Coal City
SE1/4SE1/4 sec. 11, T. 9 N., R. 6 W.
Owner: corporation
Hugh B. Lee, President
General manager: Hugh B. Lee
Products: Upper Block coal and underclay
Capacity: 1,500 tons of clay per day

58. McCool Loam Company
Chesterton
Pit location: Porter County
1 mile west of junction of Indiana Highway 149 a
U. S. Highway 20
NW1/4NW1/4 sec. 5, T. 36 N., R. 6 W.
Owner and general manager: C. O. Johnson
Products: pottery and furnace lining clays
Employees: 2
Capacity: two railroad cars per week
Raw material: glacial lake clay

59. Medaryville Tile Company
Medaryville
Pit location: Pulaski County
Southeast edge of Medaryville
NE1/4SW1/4 sec. 4, T. 30 N., R. 4 W.
Owner and general manager: Glen A. Howe

Products: farm drain tile
Fired color: red
Fired temperature: 1700° F.
Type of kiln: periodic
Capacity: 10,000 units per week
Employees: 7
Raw material: glacial till

60. Medora Brick and Tile Company
Medora
Pit location: Jackson County
1 mile north of Medora
[fol. 271] NE1/4NE1/4 sec. 27, T. 5 N., R. 3 E.
Owner: corporation
General manager: James Heller
Products: face brick and back-up brick
Fired color: red
Fired temperature: 1800° F.
Type of kiln: periodic
Capacity: 54,000 units per day
Employees: 50
Raw material: Borden shale

61. Midwest Aggregates, Inc.
Brooklyn
Pit location: Morgan County
Half a mile southwest of Brooklyn
SE1/4NE1/4 sec. 35, T. 13 N., R. 1 E.
Owner: corporation
General manager: W. G. Brierley, Jr.
Products: expanded shale
Type of kiln: rotary
Capacity: 350 cu. yds.
Employees: 20
Raw material: New Providence shale

62. Natco Corporation
Brazil, Clay County
Owner: corporation
General manager: Roy Hunter
Products: sewer tile and flue tile
Fired color: brown
Fired temperature: 2100° F.

Type of kiln: periodic
Capacity: 100 tons per day.
Employees: 100
Raw material: Upper Block underclay purchased in Brazil area

63. Natco Corporation
Hobart
Pit location: Lake County
NW1/4SW1/4 sec. 20, T. 36 N., R. 7 W.
Owner: corporation
General manager: L. E. Matheny
Products: building tile, drain tile, brick
Fired color: light red
Fired temperature: 1850° F.
Type of kiln: periodic
[fol. 272] Capacity: 200 tons per day
Employees: 65
Raw material: glacial lake clay

64. National Brick Company
3150 West Touhy Avenue, Chicago, Ill.
Pit and plant location: Maynard, Lake County
NE1/4SW1/4 sec. 31, T. 36 N., R. 9 W.
Owner: corporation
General manager: Jack Oehmke
Products: common brick
Fired color: salmon
Fired temperature: 1800° F.
Type of kiln: periodic
Capacity: 300,000 units per day
Employees: 10
Raw material: glacial lake clay

65. National Tile and Manufacturing Company
Anderson, Madison County
Owner: corporation
General manager: Richard B. Alexander
Products: floor and wall tile
Fired colors: white and red
Fired temperature: 2100° F.
Type of kiln: continuous
Capacity: 20,000 to 25,000 sq. ft. per day

45. Kokomo Sanitary Pottery Company
46. Kretz Brick Company
47. Krick-Tyndall Company
48. Lehigh Cement Company
•49. Log Cabin Coal Company
50. Lone Star Cement Corporation
51. Loogootee Clay Products Corporation
52. Louisville Cement Company
•53. Louisville Pottery Company
54. Majenica Tile Company
55. Martin Tile Company
56. Martinsville Brick Company
57. Maumee Collieries Company
•58. McCool Loam Company
59. Medaryville Tile Company
60. Medora Brick and Tile Company
61. Midwest Aggregates, Inc.
62. Natco Corporation
63. Natco Corporati
64. National Brick Company
65. National Tile and Manufacturing Company
66. Oriental Brick Company
67. Peerless Pottery, Inc.
68. Poston and Herron Brick Company
•69. Quality Coal Company
70. Rockport Drain Tile Company
71. Rockport Sanitary Pottery, Inc.
72. Rostone Corporation
73. Rostone Corporation
74. Simpson Clay Works
75. Square D Company, Molded Insulation Division
76. Standard Brick and Tile Corporation Plant No. 1
77. Standard Brick and Tile Corporation Plant No. 4
78. Stringtown Tile Company
79. Terre Haute Vitrified Brick Works
80. U. S. Brick Company
81. Veedersburg Clay Products Company
82. Herman Wessel Company

•Clay pit or mine. All others are plants, many of which have captive clay pits or mines.

Pits and plants located within cities are indicated by arrows. Numbers and names correspond to those in text.



Employees: 350
Raw material: imported domestic clays

66. Oriental Brick Company
Crawfordsville
Pit location: Montgomery County
North edge of Crawfordsville
NE1/4NE1/4NW1/4 sec. 28, T. 19 N., R. 4 W.
Owner: corporation (American Vitrified)
General manager: George Pocok
Products: brick
Fired colors: red and buff
Fired temperature: 1840° F.
Type of kiln: periodic
Capacity: 45,000 units per day
Employees: 45
Raw material: Borden shale from captive pit and underclay of Coals III and IIIa purchased near Bloomingdale

[fol. 273] 67. Peerless Pottery, Inc.
Evansville, Vanderburgh County
Owner: corporation
General manager: Charles S. Weaver
Products: sanitary ware
Fired color: white
Fired temperature: 2200° F.
Type of kiln: continuous
Capacity: 512 units per day
Employees: 130
Raw material: imported domestic and foreign clays

68. Poston and Herron Brick Company
Attica
Pit location: Fountain County
Half a mile east of Attica
SW1/4SW1/4 sec. 32, T. 22 N., R. 7 W.
Owners: Floyd Poston, W. I. Poston, and F. P. Herron
General manager: Floyd Poston
Products: brick
Fired color: red
Fired temperature: 1800° to 1850° F.
Type of kiln: periodic
Capacity: 30,000 units per day

Employees: 40
Raw material: Borden shale

69. Quality Coal Company
Brazil
Pit locations: Clay County near Cardonia and Perth
Owner: corporation
General manager: Carl F. Kumpf (President)
Products: Upper Brazil Block coal and underclay
Capacity: 65,000 tons of clay per year
Employees: 60

70. Rockport Drain Tile Company
Rockport
Pit location: Spencer County
Half a mile north of Rockport
NW1/4NW1/4 sec. 23, T. 7 S., R. 6 W.
Owner: corporation
General manager: Robert W. Richard
Products: drain and building tile and brick
Fired color: red
Fired temperature: 1800° to 1900° F.
[fol. 274] Type of kiln: periodic
Capacity: 25 tons per day
Employees: 16
Raw material: glacial river clay

71. Rockport Sanitary Pottery, Inc.
Rockport, Spencer County
Owner: corporation
General manager: G. M. Pounds
Products: tanks, bowls, and lavatories
Fired color: white
Fired temperature: 2250° F.
Type of kiln: continuous
Capacity: 2,500 units per week
Employees: 72
Raw material: imported domestic clays

72. Rostone Corporation
Lafayette
Pit location: Fountain County
2½ miles northeast of Riverside
SE1/4SE1/4 sec. 19, T. 22 N., R. 6 W.

Owner: corporation
General manager: P. W. Jones
Products: inorganic molded plastics and molded building stone
Capacity: 850 tons per year
Employees: 180
Raw material: Borden shale

73. Rostone Corporation
Lafayette
Plant location: Spencer, Owen County
Owner: corporation
General manager: Willis Sampson
Products: inorganic molded plastics
Employees: 50
Capacity: 1 ton per day
Raw material: Borden shale from Fountain County

74. Simpson Clay Works
R. R. 3, Huntington
Pit location: Huntington County
East edge of Simpson
SE1/4NW1/4 sec. 28, T. 28 N., R. 10 E.
Owner: Majenica Tile Company
General manager: Louie Mills
[fol. 275] Products: farm drain tile
Fired color: light red
Fired temperature: 1700° F.
Type of kiln: periodic
Capacity: 1,400 tons per year
Employees: 6
Raw material: glacial till

75. Square D Company, Molded Insulation Division
Peru, Miami County
Owner: corporation
General manager: C. H. Brittenham
Products: porcelain insulators, heat-shock specialities, and electrical porcelain
Fired colors: white and gray
Fired temperature: 2250° F.
Type of kiln: continuous
Capacity: 50,000 pieces per day

Employees: 400
Raw material: imported domestic clays

76. Standard Brick and Tile Corporation Plant No. 1
Evansville
Pit location: Vanderburgh County
Northwest edge of Evansville
SW1/4NE1/4 sec. 22, T. 6 S., R. 11 W.
Owner: corporation
General manager: Ralph Kleymeyer
Products: brick
Fired color: red
Fired temperature: 1950° F.
Type of kiln: continuous and periodic
Capacity: 60,000 units per day
Employees: 65
Raw material: shale from Shelburn formation

77. Standard Brick and Tile Corporation Plant No. 4
Evansville
Pit location: Vanderburgh County
Southeast edge of Evansville
SE1/4NE1/4 sec. 4, T. 7 S., R. 10 W.
Owner: corporation
General manager: Harvey Lambert
Products: face brick and drain tile
Fired color: red
Fired temperature: 1900° F.
[fol. 276] Type of kiln: periodic
Capacity: 32,000 units per day
Employees: 33
Raw material: glacial river clay

78. Stringtown Tile Company
R. R. 2, Monroeville
Pit location: Allen County
3 miles west of Monroeville
SE1/4SE1/4 sec. 10, T. 29 N., R. 14 E.
Owner and general manager: W. A. Bolyard
Products: farm drain tile
Fired color: Light red
Fired temperature: 1800° F.
Type of kiln: periodic
Capacity: 7,000 tiles per day

Employees: 6
Raw material: glacial till

79. Terre Haute Vitrified Brick Works
West Terre Haute
Pit location: Vigo County
North of West Terre Haute on U. S. Highway 150
NE1/4NE1/4 sec. 18, T. 12 N., R. 9 W.
Owner: corporation
General Manager: C. Price, Jr.
Products: brick
Fired colors: red and buff
Fired temperature: 1900° F.
Type of kiln: periodic
Capacity: 50,000 unifs per day
Employees: 50
Raw material: Upper Block underclay purchased from Brazil area and shale above Coal VII from captive pit

80. U. S. Brick Company
Tell City
Pit location: Perry County.
Half a mile north of Tell City
SE1/4SE1/4 sec. 19, T. 6 S., R. 3W
Owner: corporation
General manager: W. Eckley
Products: face brick, common brick, and tile
Fired color: red
Fired temperature: 2000° F.
Type of kiln: periodic
[fol. 277] Capacity: 67 tons per day
Employees: 25
Raw material: glacial river clay

81. Hydraulic Press Brick Co.
Veedersburg
Pit location: Fountain County
1 mile north of Veedersburg
NW1/4NW1/4 sec. 31, T. 20 N., R. 7W.
Owner: corporation
General Manager: R. E. Glover
Products: face and common brick, paving brick, and back up tile
Fired color: red

Fired temperature: 1750° to 1850° F.
Type of kiln: periodic
Capacity: 35,000 units per day
Employees: 45 to 47
Raw material: shale from Brazil formation

82. Herman Wessel Company
R. R. 3, Batesville
Pit location: Franklin County
West edge of Batesville
SW1/4SE1/4 sec. 18, T. 10 N., R. 12 E.
Owners and general managers: Wessel Brothers
Products: farm drain tile, brick, and building tile
Fired color: red
Fired temperature: 2000° F.
Type of kiln: periodic
Capacity: 700 tons per year
Employees: 3
Raw material: glacial till

[fol. 278] PRODUCERS AND CONSUMERS OF CLAY AND SHALE LISTED BY COUNTIES

Adams County

42. Jones Tile Company
47. Krick-Tyndall Company

Allen County

44. Klopfenstein Tile Company
78. Stringtown Tile Company

Blackford County

40. Inman Tile Company

Clark County

52. Louisville Cement Company

Clay County

5. American Vitrified Products Company
6. Arketex Ceramic Corporation
7. Arketex Ceramic Corporation Plant No. 2
8. Arketex Ceramic Corporation Plant No. 3
9. Arketex Ceramic Corporation Plant No. 4
11. Ayer-McCarel-Reagen Clay Company
12. Big Bend Collieries
15. Brazil Clay Company Plant No. 1
16. Brazil Clay Company Plant No. 2
17. Brazil Hollow Brick and Tile Company, Inc.
20. Brown Coal Company
26. Clay City Pottery
32. G. and F. Coal Company
43. Kalamazoo Clay Company
49. Log Cabin Coal Company
62. Nateo Corporation
69. Quality Coal Company

Daviess County

46. Kretz Brick Company

[fol. 279] **Delaware County**

33. Gill Clay Pottery Company

Dubois County

36. Huntingburg Brick Company
53. Louisville Pottery Company

Fountain County

68. Poston and Herron Brick Company
72. Rostone Corporation (pit)
84. Veedersburg Clay Products Company

Franklin County

82. Herman Wessel Company

Greene County

13. Bloomfield Brick Company

Howard County

4. American Radiator and Standard Corporation
45. Kokomo Sanitary Pottery Company

Huntington County

10. Art Chemical Products, Inc.
54. Majenica Tile Company
74. Simpson Clay Works

Jackson County

41. Jackson Brick and Hollow Ware Company
48. Lehigh Cement Company (pit)
60. Medora Brick and Tile Company

Jay County

55. Martin Tile Company

Lake County

35. Harbison-Walker Refractory Company
[fol. 280] 63. Nateo Corporation
64. National Brick Company

Lawrence County

48. Lehigh Cement Company

Madison County

65. National Tile and Manufacturing Company

Marion County

3. American Art Clay Company, Inc.

Marshall County

18. Bremen Clay Products Company

Martin County

51. Loogootee Clay Products Corporation

Miami County

75. Square D Company, Molded Insulation Division

Montgomery County

37. Hydraulic Press Brick Company
66. Oriental Brick Company

Morgan County

1. Adams Clay Products Company
19. Brooklyn Brick Company, Inc.
38. Indiana Drain Tile Company
56. Martinsville Brick Company
61. Midwest Aggregates, Inc.

Noble County

2. Albion Tile Company

[fol. 281] Owen County

57. Maumee Collieries Company (pit)
73. Rostone Corporation

Parke County

22. Cayuga Brick and Tile Corporation
24. Clay City Pipe Company
28. Dee Clay Products Company, Inc.
29. Durham and Heidbrieder Clay Company
32. G. and F. Coal Company

Perry County

21. Cannelton Sewer Pipe Company
40. U. S. Brick Company

Porter County

34. Hannell Pottery Company
58. McCool Loam Company

Pulaski County

31. Francesville Drain Tile Company
59. Medaryville Tile Company

Putnam County

39. Indiana State Farm
50. Lone Star Cement Corporation

Spencer County

70. Rockport Drain Tile Company
71. Rockport Sanitary Pottery, Inc.

Tippecanoe County

72. Rostone Corporation
73. Rostone Corporation

Vanderburgh County

27. Crown Potteries Company, Inc.
67. Peerless Pottery, Inc.
[fol. 282] 76. Standard Brick and Tile Corporation Plant No. 1
77. Standard Brick and Tile Corporation Plant No. 4

Vermillion County

6. Arketex Ceramic Corporation (pit)
23. Cayuga Brick Corporation
25. Clay City Pipe Company

Vigo County

57. Maumee Collieries Company
79. Terre Haute Vitrified Brick Works

Warrick County

14. Boonville Clay Products, Inc.
30. Engle Studio, Inc.

[fol. 283] References Cited

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Blatchley, W. S. (1905) *The clays and clay industries of Indiana*, Indiana Dept. Geology and Nat. Res., 29th Rept., pp. 13-658, 34 pls., 15 figs., 2 maps.

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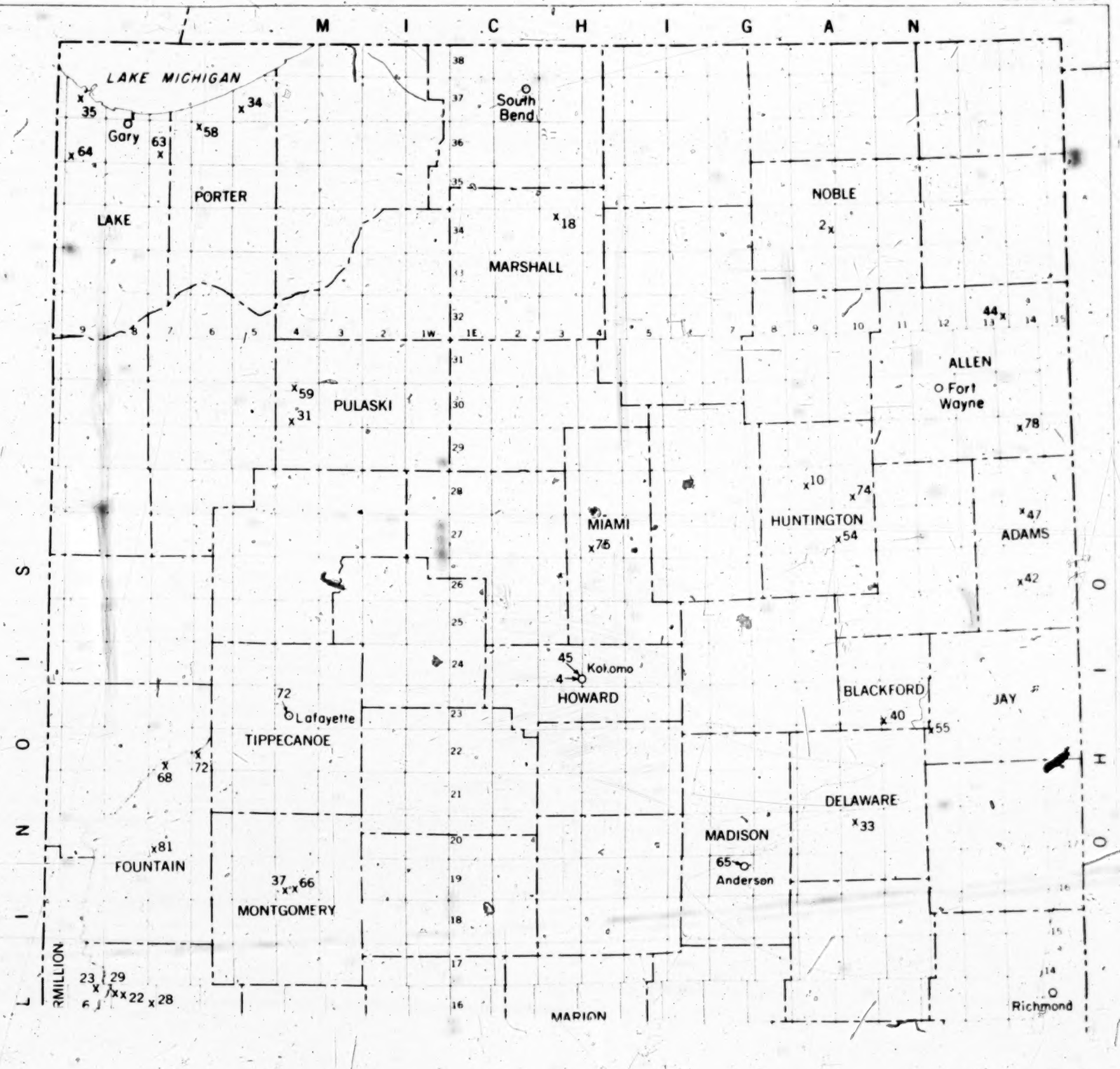
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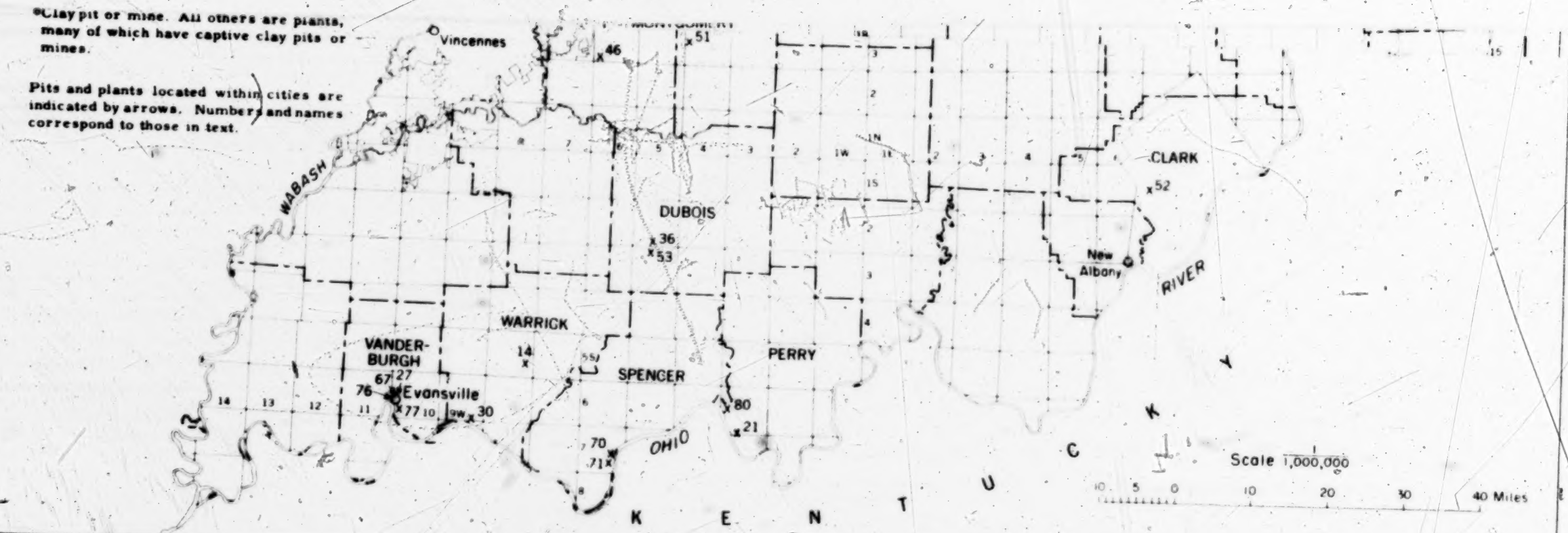
NAMES OF PITS AND PLANTS

1. Adams Clay Products Company
2. Albion Tile Company
3. American Art Clay Company, Inc.
4. American Radiator and Standard Corporation
5. American Vitrified Products Company
*6. Arketex Ceramic Corporation
7. Arketex Ceramic Corporation Plant No. 2
8. Arketex Ceramic Corporation Plant No. 3
9. Arketex Ceramic Corporation Plant No. 4
10. Art Chemical Products, Inc.
11. Ayer-McCarel-Reagen Clay Company
*12. Big Bend Collieries
13. Bloomfield Brick Company
14. Boonville Clay Products, Inc.
15. Brazil Clay Company Plant No. 1
16. Brazil Clay Company Plant No. 2
17. Brazil Hollow Brick and Tile Company, Inc.
18. Bremen Clay Products Company
19. Brooklyn Brick Company, Inc.
*20. Brown Coal Company
21. Cannelton Sewer Pipe Company
*22. Cayuga Brick and Tile Corporation
23. Cayuga Brick Corporation
24. Clay City Pipe Company
25. Clay City Pipe Company
26. Clay City Pottery
27. Crown Potteries Company, Inc.
28. Dee Clay Products Company, Inc.
*29. Durham and Heidbrieder Clay Company
30. Engle Studio, Inc.
31. Francesville Drain Tile Company
*32. G. and F. Coal Company
33. Gill Clay Pottery Company
34. Hannell Pottery Company
35. Harbison-Walker Refractory Company
36. Huntingburg Brick Company
37. Hydraulic Press Brick Company
38. Indiana Drain Tile Company
39. Indiana State Farm
40. Inman Tile Company
41. Jackson Brick and Hollow Ware Company
42. Jones Tile Company
43. Kalamazoo Clay Company
44. Klopfenstein Tile Company
45. Kokomo Sanitary Pottery Company
46. Kretz Brick Company
47. Krick-Tyndall Company
48. Lehigh Cement Company
*49. Log Cabin Coal Company
50. [illegible] Cement Corporation



*Clay pit or mine. All others are plants, many of which have captive clay pits or mines.

Pits and plants located within cities are indicated by arrows. Numbers and names correspond to those in text.



Base from Map of Indiana, 1950 edition, published by U. S. Geological Survey. Minor revisions and additions made from Indiana Department of Conservation, Geological Survey, county base maps.

MAP OF INDIANA SHOWING LOCATION OF PRODUCERS AND CONSUMERS OF CLAY AND SHALE

Compiled by H. H. Murray
November 1954

[fol. 285] PLAINTIFF'S EXHIBIT 13

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF INDIANA INDIANAPOLIS DIVISION

No. IP 57-C-163

CANNELTON SEWER PIPE COMPANY, a Corporation, Plaintiff,

vs.

UNITED STATES OF AMERICA, Defendant

STIPULATION OF FACTS No. 1

It is hereby stipulated and agreed by plaintiff and defendant in the above entitled cause that the following facts are true and may be used as evidence on the trial of this cause, subject, however, to the right of either party to object to the relevancy or materiality of any fact stated herein, and subject, further, to the right of either party to introduce further evidence not inconsistent with any of the facts stated herein.

1

The Court has jurisdiction of the parties and the subject matter of this cause of action.

2

Plaintiff is a corporation organized and existing under the laws of the State of Indiana, and has its principal office and place of business in the City of Cannelton, Perry County, Indiana, which is within the district of this Court.

3

According to "Standard Specifications for Standard Strength Clay Sewer Pipe", adopted by the American [fol. 286] Society for Testing Materials in 1954, the following definitions defined the materials referred to:

(a) Clay pipe shall be manufactured from surface clay, fire clay, or shale, or a combination of these materials;

(b) Surface Clay is an unconsolidated, unstratified clay,[1] occurring on the surface;

(c) Fire Clay is sedimentary clay[1] of low flux content;

(d) Shale is a thinly stratified, consolidated, sedimentary clay[1] with wellmarked cleavage parallel to the bedding.

4

Plaintiff, during the fiscal year ending November 30, 1951, was engaged in the business of mining a mixture of clay and shale from an underground mine located in Perry County, Indiana, and of making vitrified sewer pipe, flue lining and related products from the same, in a pipe plant owned by plaintiff in the City of Cannelton, Perry County, Indiana, which pipe is sold by plaintiff to various users throughout the Central United States.

5

All of the clay and shale which plaintiff mined during its fiscal year ending November 30, 1951 was used by plaintiff in making vitrified sewer pipe and other porducts in its said plant, except for 79.265 tons of ground fire clay and shale sold in bags,

[fol. 287] 6

This action is brought for the recovery of income and excess profits taxes paid by plaintiff to defendant and for interest paid thereon for plaintiff's taxable fiscal years ending on November 30th in each of the years 1950 and 1951, in the following amounts

	Tax	Interest	Total
1950	$ 3,487.72	$ 25.78	$ 3,513.50
1951	53,649.93	3,911.85	57,561.78
Total taxes and interest			$61,075.28

[1] The definitions for the term "surface clay", "fire clay", and "shale" are based on the following definition for the term "clay": Clay.—An earthy or stony mineral aggregate consisting essentially of hydrous silicates of alumina, plastic when sufficiently pulverized and wetted, rigid when dry, and vitreous when fired at a sufficiently high temperature.

In each of the above years, plaintiff kept its books on a fiscal year basis ending November 30th and upon the accrual basis method of accounting.

The amounts claimed by plaintiff for the fiscal year ending November 30, 1950 were paid by plaintiff to defendant as follows: $3,363.15 on October 31, 1957, and $150.35 on September 2, 1954.

The amounts claimed by plaintiff for the fiscal year ending November 30, 1951 were paid by plaintiff to defendant as follows: $16,825.56 on May 13, 1952, and $40,736.22 on July 13, 1954.

7

All of the processes used and applied by plaintiff to the clay and shale which it mined and used, were the usual and customary processes applied by manufacturers of vitrified sewer pipe and related vitrified products.

8

If, but only if, plaintiff is sustained in its contention that its first commercially marketable mineral product is the finished vitrified sewer pipe and related products sold by plaintiff, and that its clay product is fire clay, the computation of plaintiff's allowable depletion as shown on Exhibit A attached to plaintiff's complaint is correct, and the [fol. 288] computation of income and excess profits taxes due by plaintiff to defendant for the fiscal year ending November 30, 1951 shown on Exhibit B attached to plaintiff's complaint is correct, and the excess profits tax computation for plaintiff's fiscal year ending November 30, 1950 results in a refund of taxes being due to the plaintiff in the total amount of $3,487.72, together with interest paid thereon in the amount of $25.78 as set out in plaintiff's complaint.

If, but only if, plaintiff is not sustained in such contention, plaintiff's allowable depletion and the income and excess profits taxes due to defendant for plaintiff's fiscal years ending November 30, 1950 and November 30, 1951 will have to be re-computed. It is anticipated that the amount of any judgment to be entered by the Court pursuant to the pro-

visions of this paragraph, will be agreed upon by the parties once the above issues are resolved.

Royse and Travis, 1101 Fletcher Trust Building, Indianapolis 4, Indiana. By Howard P. Travis, Attorneys for Plaintiff. Don A. Tabbert, United States Attorney, By Don A. Tabbert, Attorney for Defendant.

[fol. 289] GOVERNMENT'S EXHIBIT C

CANNELTON SEWER PIPE COMPANY—Cannelton, Ind.

Date: March 10, 1958.

To: Mr. E. F. Clemens
Subject: Clay Cost for fiscal year ending November 30, 1951.
Total Tons Mined 38,474.

From: Chester
Reference:

	Total Costs	Cost Per Ton
Royalty	$7,700.65	.2002
Explosives	5,840.53	.1518
Payroll	50,754.70	1.3192
Compensation Insurance	2,094.79	.0544
Payroll Taxes	1,711.35	.0445
Mine Expense	15,938.12	.4143
Motor Truck Hauling Expense	5,017.73	.1304
Depreciation	1,420.87	.0369
Insurance	253.40	.0066
Light and Power	1,992.55	.0518
Group Insurance	323.73	.0084
Totals	93,048.42	2.4185

GOVERNMENT'S EXHIBIT C—Continued

CANNELTON SEWER PIPE COMPANY—Cannelton, Ind.

Date March 10, 1958

To: Mr. E. F. Clemens
Subject: Clay Costs for following years.

From: Chester
Reference:

Year	Total Tons Mined	Total Costs	Cost per Ton
1952	37,118	$84,120.58	2.2932
1953	36,900	69,048.96	1.8713
1954	36,600	69,916.14	1.9103
1955	43,814	88,475.09	2.0193

[fol. 290] GOVERNMENT'S EXHIBIT I

L. R. Chapman Phone 25

L. R. CHAPMAN, Inc.
Lewisport, Kentucky
Dec. 1, 1949

List of Coal Invoices hauled to the Owensboro Sewer Pipe by L. R. Chapman, Inc., for the month ending Nov. 30, 1949 incl.
Coal @ $4.25 per ton.

	Tons		Ticket No's.
1.	44.29	$ 188.23	12591-83-12612-39-41
2.	54.48	231.54	12753-16-12680-72-12736-12720
4.	33.31	141.57	12878-84-12919-31
5.	6.60	28.05	12953
6.	40.65	172.76	13038-49-76-86-91
7.	43.80	186.16	13170-58-38-28-13095
8.	44.81	190.44	13176-13232-33-13179-13205
10.	40.03	170.13	13303-13287-88-57-44
11.	26.95	114.54	13318-13-41
14.	43.60	185.30	13445-33-32-19-15
15.	60.10	255.43	13503-1-13490-8480-63-62
16.	17.44	74.12	13519-13525
17.	44.01	187.04	13550-59-79-80-87
18.	44.30	188.28	13630-21-17-13598-94
21.	49.50	210.38	13716-17-40-49-01-75
22.	31.56	134.13	13830-11-04-13790
23.	76.29	324.23	13856-63-87-13900-10-12-13-15-16
25.	51.06	217.01	13941-50-68-72-97-14002
	10.00	42.50	14034
28.	51.98	220.92	14064-66-88-96-99-14115
29.	52.25	222.06	14166-5[illegible]48-44-26-25
30.	41.96	178.33	14180-84-14204-20-22
	908.97	$3,863.12	

	Clay or Shale Tons @ $1.40 per ton		Ticket No's.
3.	44.11	$ 61.75	12760-78-12815-17-58
	236.55	331.17	13021-19-18-13-12-07-06-05-02-(1299-91 03-12997-88-87-96
11.	113.77	159.28	13366-65-62-61-60-59-58-54-53-52-51-50
19.	58.75	82.25	13706-10-11-05-13696-95
	8.40	11.76	13712
26.	154.80	216.72	14013-15-16-17-19-26-25-27-30-32
	616.38	$ 862.93	

Oct. Balance		338.14
Coal 908.97 tons =		$3,863.12
Clay or Shale 616.38 tons =		862.93
Total Balance		$5,064.19

[fol. 291] GOVERNMENT'S EXHIBIT I—Continued

L. R. Chapman — Phone 25

L. R. CHAPMAN, INC.
Lewisport, Kentucky
January 4, 1949

Coal sold to Owensboro Sewer Pipe Co.
Owensboro, Kentucky

"Coal"	
1680340 lbs. or 840.17 tons	
840.17 x $4.25	$3,570.72
Mining & Hauling Clay	
"Clay"	
3471740 lbs. or 1735.87 tons	
1735.87 x $1.40	2,430.22
Total Amount Due	$6,000.94

[fol. 292] GOVERNMENT'S EXHIBIT J

L. R. Chapman — Phone 25

L. R. CHAPMAN, INC.
Lewisport, Kentucky
Feb. 1, 1950

List of Coal & Clay Invoices that was hauled to the Owensboro Sewer Pipe Co. for the month of Jan. 1950 incl.

	Coal Invoices	No. Lbs.		Clay Invoices	No. Lbs.
2.	15829	12,140	11.	16112	14,780
	15831	19,550		16144	15,750
3.	15855	18,800		16147	16,270
	15851	11,680		16145	14,440
4.	15876	12,780		16149	10,310
	15881	19,220		16154	13,420
5.	15906	19,200		16158	15,990
	15907	12,600	12.	16155	14,160
	15898	18,080		16151	12,700
6.	15930	17,440		16143	14,330
	15942	19,000		16140	13,860
	15937	12,400		16141	15,940
7.	15954	10,630		16153	15,150
	15951	18,400		16156	14,600
	15961	18,100		16157	14,960
9.	16020	19,000		16146	15,210
	16034	19,800			
	16055	18,900			231,870 lbs.
10.	16066	18,690			
11.	16091	19,690			
	16124	18,800	231,870 lbs. = 115.93 tons		
	16107	18,600			
	16133	17,860	115.93 tons @ $1.40 = $162.30		
9.	16015	11,390			
	16067	10,950			
	16088	11,530			
		425,230 lbs.	Coal		$ 903.59
425,230 lbs. = 212.61 tons			Clay		162.30
212.61 tons Coal @ $4.25 = $903.59			Total Sales		$1,065.89

[fol. 293] IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Supplemental Appendix to Appellee's Brief

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF INDIANA, INDIANAPOLIS DIVISION

IP 57-C-163

CANNELTON SEWER PIPE COMPANY, a Corporation, Plaintiff,

vs.

UNITED STATES OF AMERICA, Defendant

COMPLAINT FOR THE RECOVERY OF TAXES PAID

First Cause of Action

1

Plaintiff brings this action against the defendant, United States of America, pursuant to the provisions of Section 1346(a)(1) of Title 28 of the United States Code, Act of June 25, 1948, C. 646, 62 Stat. 933, as amended by the Act of May 24, 1949, C. 139 Sec. 80(a), 63 Stat. 101, and the Act of July 30, 1954, C. 648, Sec. 1, 68 Stat. 589. Said section of the United States Code, as amended, confers jurisdiction on this Court over the cause of action alleged by the plaintiff herein.

2

Plaintiff is a corporation organized and existing under the laws of the State of Indiana, and has its principal office and place of business in the City of Cannelton, Perry County, Indiana, which is within the district of this Court.

[fol. 294]

3

Plaintiff brings this action to recover excess profits tax paid for the fiscal year ending November 30, 1950 in the amount of $3487.72, and to recover income tax paid for the fiscal year ending November 30, 1951 in the amount of

$53,649.93, and of interest paid by plaintiff on the tax collected for the fiscal year ending November 30, 1951, in the amount of $3,911.85.

4

Plaintiff has at all times kept its books and reported its income on the basis of a fiscal year ending on November 30th in each year. Within the time allowed by law, plaintiff filed with the Collector of Internal Revenue at Indianapolis, Indiana, its income and excess profits tax returns for the fiscal year ending November 30, 1950. Such returns showed income tax liability of $66,003.64 and excess profits tax liability of $3,363.15. Such amounts of income and excess profits tax liability were paid by plaintiff on the following dates, to-wit: Feb. 5, 1951, $16,500.91; Mar. 8, 1951, $2,000,00; May 14, 1951, $16,500.91; Aug. 9, 1951, $17,023.27; Nov. 1, 1951, $17,341.70.

5

Thereafter, on August 15, 1952, plaintiff filed its claim for refund of excess profits taxes paid, as recited in Paragraph 4, Supra, which claim was for the amount of $1,181.49; and prior to any action being taken on said claim by the Commissioner of Internal Revenue, plaintiff filed, on or about July 14, 1954, its amended claim for refund of such excess profits taxes in the amount of $3,363.15.

[fol. 295]

6

On August 17, 1954, the District Director of Internal Revenue, acting for the Commissioner of Internal Revenue, disallowed such claims for refund and notified plaintiff thereof by registered main as required by Section 3772(a)(2) of the Internal Revenue Code of 1939.

7

On July 30, 1954, the Commissioner of Internal Revenue notified plaintiff by registered mail of a deficiency assessment against plaintiff for excess profits tax for the fiscal year ending November 30, 1950, in the amount of $124.57. This deficiency assessment was paid by plaintiff, together with interest thereon in the amount of $25.78, on August 26, 1954.

8

Within the time allowed by law, plaintiff filed its income and excess profits tax returns for the fiscal year ending November 30, 1951. Such returns showed income tax liability of $95,899.57 and excess profits tax liability of $17,238.55. Thereafter, on or about August 15, 1952, plaintiff filed its amended income and excess profits tax returns for such fiscal year. Such amended returns showed income tax liability of $62,242.08 and no liability for excess profits tax. Payments were made by plaintiff on account of the tax liability shown on its original returns for such year in the total amount of $67,966.63 on the following dates, to-wit: $34,025.20 on February 8, 1952, and $33,941.43 on May 9, 1952.

[fol. 296]

9

Plaintiff, on August 15, 1952, filed its claim for refund of income and excess profits taxes paid, as recited in Paragraph 8, Supra, and, prior to an action being taken on said claim by the Commissioner of Internal Revenue, filed its amended claim for refund and abatement of taxes paid or assessed, as recited in Paragraph 8, Supra, on September 4, 1952, such amended claim being for the abatement of taxes shown on plaintiff's original return filed for such fiscal year ending November 30, 1951, in the amount of $45,171.49, and for refund of such taxes already paid in the amount of $5,724.55. The amounts claimed by plaintiff to be abated or refunded were such as to bring plaintiff's liability for such fiscal year to the amount shown on plaintiff's amended returns filed on August 15, 1952, as heretofore alleged.

10

On July 1, 1954, the Acting Regional Commissioner of the Cincinnati Region of the Internal Revenue Service notified plaintiff that its amended returns for the fiscal year ending November 30, 1951, and the amended claim for refund and abatement, had been carefully considered and as a result thereof the claim for refund and abatement was being disallowed; that a certificate of over-assessment of the liability shown on plaintiff's original returns for such year would be issued in the amount of $8,347.12, reducing

plaintiff's total tax liability for such year from $113,138.12 to $104,791.00; and that a deficiency in payment of such taxes existed in the amount of $36,824.37.

[fol. 297] 11

On July 10, 1954 a notice of tax due was sent to plaintiff by the Director of Internal Revenue in the amount of $36,824.37, and an additional amount of interest thereon in the amount of $3,911.85, which amounts were duly paid by plaintiff on July 12, 1954.

12

On or about July 15, 1954, before any action was taken by the Commissioner of Internal Revenue on the original or amended claims for refund filed by plaintiff for its fiscal year ending November 30, 1951, as alleged in Paragraph 9, Supra, plaintiff filed its Second Amended Claim for Refund of income and excess profits taxes actually paid by it for such fiscal year, such claim being for the amount of $61,932.56.

13

On October 14, 1954, the District Director of Internal Revenue, acting for the Commissioner of Internal Revenue, disallowed all of plaintiffs claims for refund for the fiscal year ending November 30, 1951 and notified plaintiff thereof by registered mail as required by Section 3772(a)(2) of the Internal Revenue Code.

14

The difference between the taxes due as computed by plaintiff and as assessed by the Commissioner of Internal Revenue arises by reason of a different theory being used to compute the deduction for depletion to which plaintiff is entitled because of its mining of fire clay and shale, as authorized by Sections 23(m) and 114(b)(4)(A), as amended, of the Internal Revenue Code of 1939.

[fol. 298] 15

Plaintiff is engaged in the business of mining a mixture of fire clay and shale from an underground mine located in Perry County, Indiana, and of making vitrified sewer

pipe, flue lining and related products from the same, in a pipe plant owned by plaintiff in the City of Cannelton, Perry County, Indiana, which pipe is sold by plaintiff to various users throughout the Central United States.

16

Section 23(m) of the Internal Revenue Code of 1939 provides that in computing net income, there shall be allowed as a deduction a reasonable allowance for depletion in the case of "mines, oil and gas wells, other natural deposits, and timber."

Effective on and after January 1, 1951, Section 114(b)(4)(A) of the Internal Revenue Code of 1939, as amended, provides that "the allowance for depletion under Section 23(m) in the case of the following mines and other natural deposits shall be—(i) in the case of * * * shale, * * * 5 per centum, * * * (iii) in the case of * * * refractory and fire clay, * * * 15 per centum, of the gross income from the property during the taxable year, excluding from such gross income any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property * * * *."

The term "gross income from the property" as used in Section 114(b)(4)(A), quoted above, is defined in Section 114(b)(4)(B) which provides that "'gross income from the property' means the gross income from mining. The term 'mining' as used herein shall be considered to include [fol. 299] not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products."

17

The mine from which plaintiff mines the clay used to make sewer pipe contains a mixture of shale and fire clay. The clay so mined and used by plaintiff for making sewer pipe during the fiscal year ending November 30, 1951 was in the proportion of forty (40%) percent shale and sixty (60%) percent fire clay. The total clay mined and used by

plaintiff during such fiscal year amounted to 38,473 tons, of which 15,389 tons were shale and 23,084 tons were fire clay.

18

All of the fire clay and shale mined by plaintiff is sold by it in the form of vitrified sewer pipe, except for a negligible amount sold as ground fire clay for use in laying firebrick and for other refractory purposes. During the fiscal year ending November 30, 1951, plaintiff's net sales of all products sold by it amounted to $1,409,145.66. Of this amount, the sale of ground fire clay amounted to $1,822.45.

19

Except for negligible amounts, there is no market for the fire clay and shale mined by plaintiff before it is put in the form of vitrified sewer pipe. Such vitrified sewer pipe sold by plaintiff is the first "commercially marketable mineral product" mined or produced by plaintiff and all mining and other processes employed by plaintiff to produce such product are those normally employed by mine operators in order to obtain such product.

[fol. 300] 20

In order to produce vitrified clay sewer pipe and related products from the raw fire clay and shale, the plaintiff applies the following processes:

A. The fire clay and shale are mined in the proportion of 60% fire clay and 40% shale from an underground horizontal drift mine, transported to the surface, loaded into dump trucks, and transported from the mine opening to the factory, a distance of 1.8 miles to plaintiff's plant.

B. The fireclay-shale mixture is crushed to approximately egg-size and stored for blending purposes.

C. The mixture is then reclaimed from storage by conveyor belt, and fed into dry pans where it is further reduced to fine-grain or powder by grinding.

D. Ground clay discharged from the dry grinding pans is carried by bucket elevator to screens, where it is screened to desired size for manufacturing into pipe, with fine-grain going to storage bins and over-size returning to the dry grinding pan.

E. The finely ground mixture is fed from storage bins to either wet pans or a pug mill for tempering with water.

F. After tempering in wet pans, the clay is conveyed to vertical steam presses where it is extruded under vacuum through dies to form sewer pipe, flue lining, wall coping, and related products.

G. Clay prepared in the pug-mill is fed continuously under vacuum into a horizontal extrusion machine which extrudes clay through a die to form sewer pipe, flue lining, filter block, drain tile, and related products.

H. Products formed on the steam press or horizontal extrusion machine are transported to drying rooms where they are dried at varying rates of speed, depending on [fol. 301] size and shape, to remove water mechanically added in the pugging process.

I. From the dry rooms the pipe is transported to and loaded in round down-draft kilns for firing.

J. Ware is fired in these kilns at varying rates of time depending on size and shape until it is vitrified.

K. When vitrification is complete, salt is injected into the kiln and a salt glaze is produced on the surface of the pipe.

L. The finished product is allowed to cool, drawn from the kilns, sorted, stored and loaded for shipment.

21

The plaintiff is entitled to compute its allowable deduction for depletion for the period from January 1, 1951 to November 30, 1951 on the basis of the allowable statutory percentages of its gross sales of vitrified sewer pipe, which is 15% of 60% of such sales as fire clay, and 5% of 40% of such sales as shale, limited, however, to 50% of the net income from the property. A computation showing plaintiff's correct allowable depletion for such period is attached hereto as Exhibit A, and such depletion deduction is in the amount of $88,908.13.

22

On the basis of plaintiff's allowable depletion for the period from January 1, 1951 to November 30, 1951, as shown in Exhibit A hereto, the total income tax for which plaintiff was liable for the fiscal year ending November 30,

1951, was in the amount of $51,141.07, as shown on Exhibit B attached hereto.

[fol. 302] 23

The Commissioner of Internal Revenue originally assessed the plaintiff for income and excess profits taxes for the fiscal year ending November 30, 1951 in the amount of $113,138.12, which was reduced by certificate of overassessment issued September 14, 1954 to the amount of $104,791.00. The Commissioner refused to allow plaintiff the 15% depletion deduction provided by law on any products sold by plaintiff during such fiscal year except on the amount of $484.74 of ground fire clay sold by plaintiff in bags. The Commissioner also determined that certain of the processes listed by plaintiff in Paragraph 21, Supra, were manufacturing rather than mining processes, and that the income attributable to such processes should be excluded from "gross income from the property". The Commissioner computed plaintiff's allowable depletion deduction for the period from January 1, 1951 to November 30, 1951 as $10,761.26, which was the entire depletion deduction allowed to plaintiff for the fiscal year ending November 30, 1951.

24

In the excess profits tax return filed by plaintiff for its fiscal year ending November 30, 1950, plaintiff showed an excess profits net income of $199,689.06 and an excess profits credit of $142,227.24. Because of the depletion allowance to which plaintiff is entitled for the fiscal year ending November 30, 1951 as hereinbefore alleged, which results in a reduction of plaintiff's excess profits net income for such year to $110,780.93, plaintiff is entitled to carry back to the fiscal year ending November 30, 1950 the unused excess profits credit from the fiscal year ending November 30, 1951 in the amount of $31,446.31, and this amount of unused excess profits credit, being greater than the ad-
[fol. 303] justed excess profits net income for the fiscal year ending November 30, 1950, results in plaintiff having no adjusted excess profits net income for the year ending November 30, 1950, and plaintiff, therefore, owed no excess profits tax for such year.

25

The Commissioner of Internal Revenue originally assessed the plaintiff for excess profits taxes for the fiscal year ending November 30, 1950 in the amount of $3,363.15, as shown on plaintiff's original excess profits tax return filed for such year. The Commissioner thereafter refused to allow plaintiff's claim for refund of such excess profits taxes and assessed the plaintiff an additional amount of excess profit tax for such year of $124.57.

26

The action of the Commissioner as described in Paragraph 23, supra, in excluding certain of plaintiff's income in the fiscal year ending November 30, 1951 from "gross income from the property" and in reducing plaintiff's deduction for depletion in such year to $10,761.26 was erroneous, illegal and without warrant in law.

27

The action of the Commissioner as described in Paragraph 25, supra, in refusing to allow for plaintiff's fiscal year ending November 30, 1950 the unused excess profits credit carry-back from the fiscal year ending November 30, 1951 in the amount of $31,446.31 and the assessment of additional excess profits tax for the fiscal year ending November 30, 1950 in the amount of $124.57, was erroneous, illegal and without warrant in law.

[fol. 304]

28

By reason of the facts set forth in this complaint in regard to the taxes due and owing by the plaintiff for its fiscal year ending November 30, 1951, there is now due and owing to the plaintiff from the defendant the sum of $57,561.78, together with interest thereon as provided by law from the dates of payment thereof, which amounts and dates of payment were—the sum of $16,825.56 on May 9, 1952, and $40,736.22 on July 10, 1954. Such sum of $57,561.78 was erroneously and illegally collected from plaintiff as income and excess profits taxes and interest thereon for such fiscal year. Although repayment thereof has been demanded, no part of such sum of $57,561.78 has

been credited, remitted, refunded or repaid to the plaintiff or to anyone on its account.

29

By reason of the facts set forth in this complaint in regard to the taxes due and owing by the plaintiff for its fiscal year ending November 30, 1950, there is now due and owing the plaintiff from the defendant the sum of $3,487.72, together with interest thereon as provided by law from the dates of payment thereof, which amounts and dates of payment were—the sum of $3,363.15 on November 1, 1951, and the sum of $150.35 on August 26, 1954. Such sum of $3,487.72 was erroneously and illegally collected from plaintiff as excess profits tax and interest thereon for such fiscal year. Although repayment thereof has been demanded, no part of such sum of $3,487.72 has been credited, remitted, refunded or repaid to the plaintiff or to anyone on its account.

[fol. 305] 30

On the 17th day of July, 1956, the Commissioner of Internal Revenue and the plaintiff entered into an agreement to suspend the running of the statute of limitations for bringing suit by plaintiff for the recovery of the taxes alleged to have been overpaid for each of the fiscal years ending November 30, 1950 and November 30, 1951, by the terms of which the running of the statute of limitations as specified in Section 6532 of the Internal Revenue Code of 1954 was suspended from the said 17th day of July, 1956 to August 31, 1957. A copy of said agreement for the fiscal year ending November 30, 1950 is attached hereto and marked "Exhibit C". A copy of said agreement for the fiscal year ending November 30, 1951 is attached hereto and marked "Exhibit D". The filing of this action is, therefore, within the time allowed by law.

Wherefore, plaintiff prays for judgment against the defendant in the principal amount of $61,049.50 and interest thereon as provided by law from the dates of payment thereof as hereinabove specified, together with the costs of this action.

Royse and Travis, 1011 Fletcher Trust Building, Telephone—Melrose 2-4417, By Howard P. Travis, Attorneys for Plaintiff.

[fol. 306] Second Cause of Action

1

As part of its Second Cause of Action, plaintiff hereby re-alleges and re-avers each and all of the factual allegations set forth in plaintiff's First Cause of Action in rhetorical paragraphs numbered 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 23, 25, 26, 27, 29 and 30 thereof.

2

During the period January 1, 1951 to November 30, 1951, plaintiff sold a certain amount of its production of fire clay and shale in the form of ground fire clay in bags of 100 pounds and 10 pounds, and the total tonnage so sold by plaintiff amounted to 79.625 tons. The average sales price per ton of such ground fire clay so sold by plaintiff was $17.464.

3

If, but only if, plaintiff is not entitled to compute its allowable deduction for depletion on the basis of the net sales of vitrified sewer pipe and other products produced by plaintiff, all as set out in plaintiff's First Cause of Action herein, then plaintiff is entitled to compute its allowable depletion deduction on the basis of the use by plaintiff of the tonnage of fire clay and shale used to produce vitrified sewer pipe and other products all at a price of $17,464 per ton. During the fiscal year ending November 30, 1951, plaintiff mined and used in producing vitrified sewer pipe and other products a total of 38,473 tons of fire clay and shale, of which 23,084 tons was fire clay and 15,389 tons was shale. Plaintiff is entitled to a depletion deduction of 15% of the value of such fire clay and 5% [fol. 307] of the value of such shale, and plaintiff's allowable depletion deduction for the fiscal year ending November 30, 1951, computed on the theory set out in this paragraph, is in the amount of $66,857.05.

4

On the basis of plaintiff's allowable depletion deduction for the period from January 1, 1951 to November 30, 1951 as set out in this cause of action, the total income tax for

which plaintiff was liable for the fiscal year ending November 30, 1951, was in the amount of $62,242.08, and plaintiff is entitled to recover from the defendant all of the amount paid by plaintiff in excess of such sum, together with interest thereon as provided by law.

Wherefore, plaintiff prays for judgment against the defendant in such sum as is proper under the theory alleged in this cause of action, together with interest as provided by law, from the dates of payment of taxes by plaintiff as hereinabove alleged, together with the costs of this action.

Royse and Travis, 1011 Fletcher Trust Building, Telephone—Melrose 2-4417, By Howard P. Travis, Attorneys for Plaintiff.

[fol. 308] IN THE UNITED STATES DISTRICT COURT.

(Caption 57-C-163)

ANSWER.

Comes now the United States of America by its attorney Jack C. Brown, United States Attorney for the Southern District of Indiana, and answers the allegations of the complaint as follows:

First Cause of Action

1

Admits the allegations contained in paragraph 1 of the complaint.

2

Admits the allegations contained in paragraph 2 of the complaint.

3

Admits the allegations contained in paragraph 3 of the complaint, except that any liability is denied thereunder.

4

Admits the allegations contained in paragraph 4 of the complaint. Defendant avers that the amounts of income

and excess profits tax liability in the amounts alleged were paid by plaintiff for the fiscal year ending November 30, 1950, on the following dates, to wit: February 9, March 15, June 20, August 10, and October 31, 1951.

[fol. 309]

5

Admits the allegations contained in paragraph 5 of the complaint, except it is not intended to admit any of the allegations set forth in said claim for refund not expressly admitted elsewhere in this answer.

6

Admits the allegations contained in paragraph 6 of the complaint.

7

Admits the allegations contained in paragraph 7 of the complaint. Defendant avers the alleged deficiency assessed was paid by plaintiff together with interest thereon on September 2, 1954.

8

Admits the allegations contained in paragraph 8 of the complaint. Defendant avers that the amounts of income and excess profits tax liability in the amounts alleged were paid by plaintiff for the fiscal year ending November 30, 1951, on the following dates, to wit: February 21, and May 13, 1952.

9

Denies the allegations contained in paragraph 9 of the complaint, except it is admitted that on August 15, 1952, plaintiff filed its claim for refund of income and excess profits taxes paid for the fiscal year ending November 30, 1951, and that prior to any action being taken on said claim by the Commissioner of Internal Revenue, plaintiff filed its amended claim for refund on September 4, 1952, for the fiscal year ending November 30, 1951, except it is not intended to admit any of the allegations set [fol. 310] forth in the said claim for refund or the amended claim for refund not expressly admitted elsewhere in this answer.

10

Admits the allegations contained in paragraph 10 of the complaint.

11

Admits the allegations contained in paragraph 11 of the complaint. Defendant avers that the alleged amount of tax assessed and interest thereon were duly paid by plaintiff on July 13, 1954.

12

Admits the allegations contained in paragraph 12 of the complaint.

13

Admits the allegations contained in paragraph 13 of the complaint.

14

Denies the allegations contained in paragraph 14 of the complaint.

15

Denies the allegations contained in paragraph 15 of the complaint except it is admitted that plaintiff is engaged in the business of making vitrified sewer pipe, flue lining and related products from the same, in a pipe plant owned by plaintiff in the City of Cannelton, Perry County, Indiana, which pipe is sold by plaintiff to various users throughout the Central United States.

[fol. 311]

16

Denies the allegations contained in paragraph 16 of the complaint for the reasons that the applicable sections of the Internal Revenue Code of 1939 speak for themselves.

17

Denies the allegations contained in paragraph 17 of the complaint.

18

Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 18 of the complaint.

19

Denies the allegations contained in paragraph 19 of the complaint.

20

Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 20 of the complaint.

21

Denies the allegations contained in paragraph 21 of the complaint.

22

Denies the allegations contained in paragraph 22 of the complaint.

[fol. 312]

23

Denies the allegations contained in paragraph 23 of the complaint, except it is admitted that plaintiff reported on its income and excess profits tax return for the fiscal year ending November 30, 1951, taxable liability in the amount of $113,138.12, which was reduced by the Commissioner of Internal Revenue by certificate of over-assessment issued September 14, 1954, to the amount of $104,791; it is further admitted that the Commissioner computed plaintiff's allowable depletion deduction for the period January 1, 1951, to November 30, 1951, as $10,761.26 which was the entire depletion deduction allowed to plaintiff for the fiscal year ending November 30, 1951.

24

Denies the allegations contained in paragraph 24 of the complaint.

25

Denies the allegations contained in paragraph 25 of the complaint, except it is admitted that plaintiff's original excess profits tax return filed for the fiscal year ending November 30, 1950, reported an excess profits tax liability of $3,363.45 and it is further admitted that the Commissioner of Internal Revenue assessed the plaintiff an additional amount

of excess profits tax for the fiscal year ending November 30, 1950, in the amount of $124.57.

26

Denies the allegations contained in paragraph 26 of the complaint.

[fol. 313] 27

Denies the allegations contained in paragraph 27 of the complaint.

28

Denies the allegations contained in paragraph 28 of the complaint except it is admitted that no part of the alleged sum of $57,561.78 has been credited, remitted, refunded or repaid to the plaintiff or to anyone on its account.

29

Denies the allegations contained in paragraph 29 of the complaint except it is admitted that no part of the alleged sum of $3,487.72 has been credited, remitted, refunded or repaid to the plaintiff or to anyone on its account.

30

Admits the allegations contained in paragraph 30 of the complaint.

Second Cause of Action

1

Defendant realleges and reavers each and all of the allegations set forth in defendant's first cause of action in answer to rhetorical paragraphs numbered 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 23, 25, 26, 27, 29 and 30 thereof.

2

Defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 2 of the complaint.

[fol. 314] 3

Denies the allegations contained in paragraph 3 of the complaint.

4

Denies the allegations contained in paragraph 4 of the complaint.

Wherefore, defendant demands judgment be entered in its favor dismissing plaintiff's complaint with allowable costs.

Jack C. Brown, United States Attorney.

UNITED STATES DISTRICT COURT.

* * (Caption—57-C-163) * *

PRE-TRIAL ORDER.—ENTERED FEB. 12, 1958

A pre-trial conference was held in the above entitled cause before Honorable Cale J. Holder, Judge, on the 7th day of January, 1958.

Mr. Howard P. Travis of Indianapolis, Indiana, appeared as counsel for plaintiff; Mr. Ernest C. Friesen, Attorney, Tax Division, Department of Justice, Washington, D. C., and Mr. John Carl Vandivier, Jr., Assistant United States Attorney for the Southern District of Indiana, appeared as counsel for defendant.

I

In general, plaintiff claims that it is entitled to recover the sum of $57,561.78, together with interest thereon as provided by law from the dates of payment thereof, on account of a deduction for depletion for the clay mined and used by plaintiff during the fiscal year ending November 30, 1951, [fol. 315] which deduction was disallowed to the plaintiff by the Commissioner of Internal Revenue of the defendant, plaintiff's claim being based on the provisions of Section 114 (b) (4) (B) of the Internal Revenue Code of 1939 as amended, and plaintiff claims an additional amount of $3,487.72, together with interest thereon, as excess profits tax

paid by the plaintiff for the fiscal year ending November 30, 1950, by virtue of the decision in *United States* v. *Merry Brothers Brick and Tile Co., et al.*, 242 F. 2d 708, certiorari denied October 14, 1957.

II

Counsel for the defendant represented to the court that the defendant, through its Internal Revenue Service, had initiated as of this date a survey regarding the sales of shale and fire clay in a certain marketing area which would include the location of the plaintiff's mine and factory, to determine whether or not the defendant will claim in this cause of action that plaintiff has a market for the clay which it mines prior to being put in the form of finished vitrified sewer pipe and other related products which are made and sold by the plaintiff; and further, that if the defendant determined that there was such a market, then an additional survey would be made to determine the market value of the clay mined by plaintiff at the point where the defendant determined that there was a market for the clay.

Counsel for the defendant further represented that if it were determined as a result of the survey that there was no market for clay and shale of the type mined or used by plaintiff prior to its being put in finished form ready for sale, then plaintiff's claims as alleged in plaintiff's complaint would be recommended for administrative refund by the Internal Revenue Service of defendant.

[fol. 316] III

Counsel for plaintiff represented that the clay which it mines and uses in its production of vitrified sewer pipe and other products consisted, during the period involved in this cause of action, of 40 per cent shale and 60 per cent fire clay having a pyrometrical cone equivalent of 17, and that plaintiff during the period involved made no sales of raw shale or fire clay but did make sales of ground fire clay in an amount of 79,625 tons out of a total amount of clay mined and used by plaintiff during the fiscal year ending November 30, 1951, of 38,473 tons.

IV

If this cause of action is to be tried by the court, it was agreed between the parties that the only issues of fact which would have to be presented to the court would be first, whether the plaintiff has any "commercially marketable product or products" from the shale and clay which it mines prior to the finished vitrified sewer pipe and other products which plaintiff produces and sells; and, second, what is the value of such "commercially marketable product or products" if it is determined that plaintiff has such a product or products prior to the completed vitrified sewer pipe and other products which plaintiff makes and sells.

V

At the request of counsel for defendant, and with the consent of counsel for plaintiff, the court stated that this cause would be removed from the trial calendar for January 13, 1958, and that if the case was to be tried by the court it would be reset in March, 1958, with at least one week's notice to counsel for plaintiff and defendant before the date set for trial.

[fol. 317]

VI

The court instructed counsel for both parties that if the defendant decides to proceed with the trial of this cause, a stipulation of facts should be filed with the court in duplicate not later than February 15, 1958, and that trial briefs should be filed with the court by both parties not later than one week before the date set for trial.

VII

The probable length of the trial of this case would be not more than one day.

Approved: Howard P. Travis, Attorney for Plaintiff. Don A. Tabbert, Attorney for Defendant.

Dated and entered at Indianapolis, Indiana, this 12th day of February, 1958.

Cale J. Holder, Judge.

[fol. 318] IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

September Term, 1958 — April Session, 1959

No. 12496

CANNELTON SEWER PIPE COMPANY, Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA, Defendant-Appellant.

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.

OPINION—June 15, 1959

Before DUFFY, *Chief Judge*, HASTINGS and KNOCH, *Circuit Judges*.

HASTINGS, *Circuit Judge*. Taxpayer, Cannelton Sewer Pipe Company, brought this suit in the district court for a refund of income tax paid in 1951. The sole question before us is what constitutes the proper basis for the computation of percentage depletion to which taxpayer is entitled. At all times relevant to this proceeding, taxpayer was engaged, near Cannelton, Indiana, in the mining of fire clay and shale and the manufacture of vitrified clay sewer pipe and related products. Under provisions of the Internal Revenue Code of 1939,[1] taxpayer was permitted a percentage depletion on its fire clay of 15% and, on its shale, of 5% of "the gross in-[fol. 319] come from the property during the taxable year * * *." 26 U.S.C.A. § 114(b)(4)(A) (1939 I.R.C.). The district court held that taxpayer could compute its deduction for depletion on the basis of its gross income from the sale of its finished products. The Government contends such holding is erroneous.[2]

[1] Reference to "the Code" in this opinion will be to the Internal Revenue Code of 1939.

[2] There was also before the trial court a question whether or not taxpayer's clay was "fire clay" but the Government has not taken issue in this appeal with the trial court's finding that taxpayer's product met the specifications of fire clay.

Section 114(b)(4)(B) of the Code provided, in pertinent part, that:

> "The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the *ordinary treatment processes normally applied by mine owners or operators* in order to obtain the *commercially marketable mineral product or products* * * *." (Emphasis added.)

It is taxpayer's position that the processes by which it produced vitrified sewer pipe and related products from its raw fire clay and shale qualify as "ordinary treatment processes" within the meaning of the above statutory language since it had no market for its minerals in crude form and such processes were of necessity applied by it in order to obtain the first commercially marketable products. The Government urges that, in 1951, there was an existing substantial market for raw fire clay and shale in Indiana and in the area surrounding taxpayer's mine; and, that, in light of this fact, raw fire clay and shale were taxpayer's first commercially marketable products.

Taxpayer contends that the sole question on this appeal is whether there is substantial evidence to support the trial court's finding that vitrified sewer pipe and other finished products were taxpayer's first commercially marketable products. We do not agree that the issues are so limited. An overriding consideration is whether the trial court applied the correct legal criteria in making such a determination. The record clearly bears out the Government's assertion that there existed in Indiana, during 1951, a substantial market for fire clay and shale. At the same time, it is also apparent from the record [fol. 320] that taxpayer could not have sold its fire clay and shale in that market *at a profit* because of prohibitively high mining and transportation costs. The question squarely presented is thus whether the statutory language which defines, as a part of "mining", "all ordinary treatment processes normally applied by mine owners" to produce "the commercially marketable mineral product or products", includes all processes necessary by a taxpayer to obtain a product *which can be sold by it at a profit*. The

Government urges that "mining" includes only the processes necessary for a taxpayer to produce a product which, with the least processing, is "marketable", *i.e.*, for which there is a market; and that it is not material whether or not it is economically feasible for a taxpayer to sell in that market. This theory presupposes that there would be a marketable or "depletable" product for each raw or crude mineral, and that the depletion allowance would be computed on this marketable or depletable product.[3]

The Government has attempted, in a number of cases and with conspicuous lack of success, to limit the scope of the definition of mining contained in Section 114(b)(4)(B) here before us. Courts of Appeals in four different federal judicial circuits have uniformly and unhesitatingly rejected such endeavors to narrow the application of the

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[3] Section 29.23(m)-1(f) of Treasury Regulations 111 provides a method for the computation of the gross income as follows:

> "If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, 'gross income from the property' means the amount for which such product was sold; but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, 'gross income from the property' means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. * * *"

provision's language. In *United States* v. *Cherokee Brick & Tile Company*, 5 Cir., 218 F. 2d 424 (1955) the Govern- [fol. 321] ment urged unsuccessfully that since burnt brick and tile were *manufactured* rather than *mineral* products, the processes by which raw brick and tile clay were transformed into burnt brick and tile could be no part of mining for depletion purposes. The Court of Appeals for the Fifth Circuit held that the processes used to produce the burnt brick and tile were the ordinary treatment processes needed to produce the first commercially marketable products. That court has since reaffirmed its holding in the *Cherokee* case in *United States* v. *Merry Brothers Brick & Tile Company*, 5 Cir., 242 F. 2d 708 (1957) and, indeed, therein expressly rejected the Government's request that, upon reconsideration and re-examination, it should reverse its previous ruling. The Court of Appeals for the Tenth Circuit, citing the *Cherokee* case, similarly held against the Government in a case also involving brick and tile clay. *United States* v. *Sapulpa Brick and tile Corporation*, 10 Cir., 239 F. 2d 694 (1956). In *Dragon Cement Company* v. *United States*, 1 Cir., 244 F. 2d 513 (1957), the Government contended that cement was a manufactured product which was chemically different in composition from the depletable product, cement rock, and that, therefore, the taxpayer could not use the gross income from sale of cement as its basis for computing percentage depletion. This was rejected by the Court of Appeals for the First Circuit. Finally, in *Townsend* v. *The Hitchcock Corporation*, 4 Cir., 232 F. 2d 444 (1956), it was held that the grinding and bagging of talc and the cutting of talc into crayons were ordinary treatment processes by which mine owners obtained the commercially marketable products, even though the final products were manufactured.

In all the above cases, the Government's basic contention was that manufacturing processes could not be "ordinary treatment processes" within the meaning of the Code. Likewise, in each of these cases, the Government readily admitted that each taxpayer had no market, or a market for only a negligible quantity, of the particular raw mineral involved; but urged that this fact was of no consequence since the overriding consideration was that

depletion could not be allowed on the sale of manufactured products.

That argument has definitely been laid to rest; the Government has not renewed it before this court. The courts [fol. 322] in the above cases uniformly held that the prime consideration was whether taxpayer applied the normal processes necessary to produce the first commercially marketable product, even though what are usually considered manufacturing processes were applied; and the question was treated as one of fact.[4]

The Government contends that the trial court misinterpreted the above cases as holding that a taxpayer could take depletion on its finished product regardless of whether it was the first commercially marketable product. As it points out, in this case it did not admit the nonmarketability of fire clay and shale. Indeed, the Government's evidence indicates that large quantities of fire clay and shale were sold during the tax year, 1951. Thus, in Indiana, of 82 companies engaged in the production or consumption of fire clay and shale, 32 purchased fire clay or shale, or both, for use in their manufacturing operations. Seven producers of fire clay and two producers of shale in Indiana engaged in nonintegrated operations, that is, strictly in the extraction of the raw fire clay and shale and not in further processing. These companies necessarily took depletion on the raw fire clay and shale which

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[4]The Court of Appeals for the Fifth Circuit stated in *United States* v. *Cherokee Brick & Tile Company*, *supra* at 425, that:

> "* * * [T]he crucial point in this case is one of fact, not of law; and the pleadings admit that fact to be against the Government.
>
> * * *
>
> "The complaint alleges that, of the brick and tile clay mined in the United States, there is opportunity for the sale of only a negligible quantity before it is put into the form of burnt brick and tile. This allegation is admitted in the answer of the appellant. For this and other reasons (but mainly for this one) stated in the opinion of the district court, * * * the judgment appealed from should be affirmed."

they sold. Taxpayer's own expert witness, Haydn H. Murray, admitted, on cross-examination, that over 300,000 short tons of fire clay (of some 500,000 short tons produced) were sold in Indiana in 1951 rather than used by the producer in integrated manufacturing operations.

The taxpayer points out that a good percentage of the clay and shale, actually sold, was sold in the Brazil, Indiana area at prices ranging from $1.60 to $1.90 per ton delivered in the Brazil area. Taxpayer's mining costs alone, ignoring for the moment the transportation costs which would be an added expense if it sought to sell its raw clay and shale, amounted to $2.41 per ton. Those [fol. 323] companies selling fire clay in Indiana concerning which the Government introduced evidence fall into two categories. There are those operators who engage primarily in strip mining of coal and, who, during their operations, strip bare so-called underclay which they sell as a by-product. Secondly, there are those which mine underclay which has already been laid bare by previous strip mining operations. The mining costs of such operators would be considerably below those of taxpayer which operated an underground mine. Further, several of the operators of those mines discussed above could not find a market for all the clay which they had available for sale.

We agree with the taxpayer that it did not have a *commercially* marketable product in its fire clay and shale. We are unable to accept the theory that a taxpayer's depletion allowance is to be computed on the basis of a representative market or field price for a product which taxpayer could not sell at a profit. To do so would be to deprive of all meaning the words "commercially marketable" as used in the Code provision here considered.[5] The

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[5] In *Arvonia-Buckingham Slate Company* v. *United States*, D.C. E.D. Va., 167 F. Supp. 903 (1958) the district court was faced with and rejected the contention that taxpayer involved had a marketable product in unprocessed slate even though the record showed that it was economically unfeasible for taxpayer to mine slate suitable for sale at a profit until it processed the slate into roofing slate shingles. The nature of the seam which taxpayer worked made it necessary for it to blast the slate free and the waste

integrated operations of taxpayer in this case (that is, combined mining and manufacture) were certainly not unique. The evidence the Government used to establish the existence of a market for taxpayer's fire clay indicates, [fol. 324] in fact, that the integrated miner-manufacturer was the rule rather than the exception in Indiana, in 1951. The fact that certain operators of strip mines found it economically feasible to extract and sell fire clay primarily in a limited area near Brazil, Indiana does not alter this picture. Finally, there is no contention that taxpayer applied other than ordinary treatment processes in obtaining its finished products.

In line with its theory that there must be one depletable or commercially marketable product for each mineral, the Government urges that if raw fire clay and shale are not those products for this taxpayer, this case should nevertheless be remanded for further evidence to determine if some other products could have been, with much less processing, the depletable products for this taxpayer. It is suggested that such products could be common brick and

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slate, consisting of pieces unsuitable for shingles, sold for only ten cents a ton. In *Riverton Lime and Stone Co.* v. *Commissioner of Internal Revenue*, 28 T.C. 446, 448 (1957) the Tax Court held that hydrated limestone was taxpayer's first commercially marketable product for "[w]hile it may have been possible to use petitioner's limestone in its quarried state for agricultural purposes, petitioner could not, and did not, sell it in this market because of the abundance of other limestone in the area which was chemically more suited to the farmers' needs." The Government points out in its brief that appeals are now pending from similar adverse holdings in the following cases: *Iowa Limestone Co.* v. *Commissioner*, 28 T.C. 881 (1957), now pending on appeal to the Eighth Circuit and involving the question of whether crushed rather than pulverized limestone is a taxpayer's first commercially marketable product; *Sparta Ceramic Company* v. *United States*, D.C.N.D. Ohio, 168 F. Supp. 401 (1958), on appeal to the Sixth Circuit and involving fire clay; and *Pacific Clay Products* v. *United States*, (S.D. Calif.), decided October 30, 1958, on appeal to the Ninth Circuit and involving both fire clay and brick and tile clay.

ground fire clay.[6] The short answer to this is that we do not agree that it was intended that the depletion allowance for each mineral be reduced to the common denominator represented by a conceivable product most cheaply produced from each mineral. In *United States* v. *Cherokee Brick & Tile Company*, *supra*, and *United States* v. *Sapulpa Brick and Tile Corporation*, *supra*, the Fifth and Tenth Circuits, respectively, allowed depletion on both *brick* and *tile*. In *Townsend* v. *The Hitchcock Corporation*, *supra*, both *talc powder* and *talc crayons* were treated as depletable products.

This is not to say, of course, that a product may be processed beyond the stage at which it is a commercially marketable product. In *Sparta Ceramic Co.* v. *United States*, D.C.N.D. Ohio, 168 F. Supp. 401 (1958), the district court recognized this limitation when it refused to allow depletion on the basis of gross income from sales of glazed tile rather than on the representative market price of the unglazed product. Although glazing was accomplished at the time the tile was burnt, about 65% of taxpayer's end product was unglazed and was, in fact, commercially marketable. As the court pointed out, glazing could no more be a necessary treatment process than gold plating, should taxpayer seek to enhance the value of the product by such means. As we have indicated, there is no contention here that the instant taxpayer applied other [fol. 325] than normal treatment processes in obtaining its finished products.

The Government relies on *Riverton Lime and Stone Co.* v. *Commissioner of Internal Revenue*, 28 T.C. 446 (1957) as authority for the proposition that a small market can establish a representative market or field price for a product. However, in that case it was held merely that, although there were only a few sales of hydrated hydraulic lime in the pure state, the taxpayer could compute its gross income on the market price of that product. Most of taxpayer's sales were of an admixed product rather than a pure product and the Commissioner contended that

[6] There was evidence that taxpayer did sell some 80 tons of ground fire clay at a little more than twenty dollars per ton.

gross income should be computed on the admixed product by the proportionate profits method[7] since the limited market for pure lime established no representative market or field price for pure lime. That case has no bearing on the problem before us since taxpayer here could not and did not sell its raw fire clay or shale prior to processing.

We find nothing in the opinion in *Alabama By-Products Corporation* v. *Patterson*, 5 Cir., 258 F. 2d 892 (1958) recently handed down by the Court of Appeals for the Fifth Circuit to indicate that that court has modified its earlier holdings in the *Cherokee* and *Merry Brothers* cases. The court merely recognizes in footnote 12 on pages 899-900 of that opinion that neither of those cases involved a question of the existence of a representative market price since in both cases the Government had admitted nonmarketability of the crude brick and tile clay.[8]

The decision of this court in *Zonolite Co.* v. *United States*, 7 Cir., 211 F. 2d 508 (1954) relied upon by the Government is not controlling here. In that case we held only that income received by taxpayer for transporting its mineral product from the mine to place of sale was not includible in the gross income from "mining." In other words we held that such transportation was beyond ordinary treatment processes since taxpayer's product was [fol. 326] a commercially marketable product before such transportation costs were incurred. The holding in the instant case is entirely consistent with that decision.

The judgment of the district court is

Affirmed.

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[7] See Section 29.23(m)-1(f) of Treasury Regulations 111, *supra* note 3.

[8] As the taxpayer points out in its brief, at the time the Government appealed from the district court's holding in the *Merry Brothers* case to the Court of Appeals for the Fifth Circuit, the Government stipulated that five other clay and shale cases should be affirmed if the court adhered to its ruling in the *Cherokee* case. Three of those cases involved fire clay.

[fol. 327] UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 12496

CANNELTON SEWER PIPE COMPANY, Plaintiff-Appellee,

vs.

UNITED STATES OF AMERICA, Defendant-Appellant

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division

JUDGMENT—June 15, 1959

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Indiana, Indianapolis Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, in accordance with the opinion of this Court filed this day.

[fol. 328] Clerk's Certificate Omitted in Printing.

[fol. 329] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1959

No. 513

UNITED STATES OF AMERICA, Petitioner,

vs.

CANNELTON SEWER PIPE COMPANY

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—September 10, 1959

Upon consideration of application of counsel for petitioner,

It is ordered that the time for filing petition for writ of certiorari in the above entitled cause be, and the same is hereby, extended to and including November 12th, 1959.

Tom C. Clark, Associate Justice of the Supreme Court of the United States.

Dated this 10th day of September, 1959.

[fol. 330] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1959

No. 513

UNITED STATES, Petitioner,

vs.

CANNELTON SEWER PIPE COMPANY

ORDER ALLOWING CERTIORARI—December 14, 1959

The petition herein for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit is granted.

And it is further ordered that the dul certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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Supreme Court, U.S.
FILED
NOV 4 1959
JAMES R. BROWNING, Clerk

No. 513

In the Supreme Court of the United States

OCTOBER TERM, 1959

UNITED STATES OF AMERICA, PETITIONER

v.

CANNELTON SEWER PIPE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1959

No.

UNITED STATES OF AMERICA, PETITIONER

v.

GANNELTON SEWER PIPE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in the above-entitled case.

OPINIONS BELOW

The District Court wrote no opinion. Its findings of fact and conclusions of law (R. 3-8) are not officially reported. The opinion of the Court of Appeals (App. A, *infra*, pp. 21-32) is reported at 268 F. 2d 334.

JURISDICTION

The judgment of the Court of Appeals was entered on June 15, 1959. (App. A, *infra*, p. 32.) By order

of Mr. Justice Clark, dated September 10, 1959, the time for petitioning for a writ of certiorari was extended to November 12, 1959. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTION PRESENTED

Taxpayer, an integrated miner-manufacturer, mines fire clay and shale and, utilizing these minerals, manufactures sewer pipe and other finished products. There is an extensive market for fire clay and shale, but taxpayer does not sell on the mineral market; its mining costs are high and it would be unprofitable for taxpayer to do so.

Under the Internal Revenue Code, miners of designated minerals are entitled to a depletion allowance determined by applying a specified percentage to the taxpayer's gross income from "mining". "Mining" is defined as including "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *."

The question presented by this case is whether the commercially marketable products, for purposes of determining taxpayer's allowance for mineral depletion, are fire clay and shale (the cut-off point for all non-integrated miners of these minerals) or whether, as held below, taxpayer may include in its gross income from "mining" the proceeds received from sale of sewer pipe and other finished products of its factories.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions and Treasury Regulations are Sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939 and Section 29.23 (m)-1(f) of Treasury Regulations 111, printed in Appendix B, *infra*, pp. 33-38.

STATEMENT

Taxpayer, an Indiana corporation, has its principal place of business in southwestern Indiana (R. 4-5, 240). During the taxable year ended November 30, 1951, it was engaged in the mining of fire clay[1] and shale and in manufacturing those minerals (in 60-40 proportions) into vitrified sewer pipe, flue lining, wall coping and filter blocks. (R. 5.) During 1951, it mined 38,473 tons of fire clay and shale,[2] of which 60 percent (about 23,084 tons) was fire clay. It sold no raw fire clay or shale, except for 80 tons of clay and shale sold in ground form for $1,822.45

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[1] Fire clay, for which depletion is allowed at a 15-percent rate, is to be distinguished from brick and tile clay, for which only a 5-percent rate of depletion is allowed.

[2] The fire clay and shale which taxpayer mines is from a geological formation, generally called the Pennsylvania formation, which, in Indiana, is located in the southwestern part of the State extending northward. The same formation extends into Kentucky directly across the river from Cannelton, Indiana. (R. 48.) The fire clay in the formation is known as Pennsylvania underclay and lies directly beneath a thin layer of coal. (R. 5, 29, 146.) The shale, which is also a clay but contains some iron and is darker than fire clay when fired (R. 218), lies beneath the underclay (or fire clay). (R. 250).

(R. 5.) The remainder was used in manufacturing its finished products, the sales prices of which totalled $1,409,145.66. (R. 5.)

Fire clay and shale are used in the manufacturing of a variety of different products. In Indiana, for example, fire clay is used in making refractory brick, pottery, structural title, farm drain tile, face brick, sewer pipe, flue linings, conduit pipe and insulators. Shale is also used for most of those purposes, as well as in the production of cement and for paving brick and lightweight aggregate. (See Ex. A; R. 253.)

Fire clay and shale are sold in large quantities in their raw form (App. A, *infra*, p. 26). Thus, there were 31 states (including Indiana) in which fire clay was sold and purchased during 1951 and, of a total of 11,852,517 tons produced, more than one-fourth (3,159,667 tons) was sold rather than used by the producers thereof in making finished products from it. (See Minerals Yearbook (1951), Bureau of Mines, Department of the Interior, p. 294; see, also, R. 168; Ex. A, R. 252.)[3] Of the more than 500,000 short tons of fire clay produced in Indiana in 1951, over 300,000 tons were sold rather than used by the producers thereof. (App. A, *infra*, p. 27.) In that year, seven Indiana producers of fire clay and two Indiana producers of shale engaged in non-integrated operations—that is, strictly in the extraction of the raw fire clay and shale—and necessarily received

[3] The shale statistics, contained in the Minerals Yearbook, *supra*, p. 300, are included under the heading of "Miscellaneous Clays," of which 3.6 percent (989,739 tons) was sold in raw form.

depletion only on the raw fire clay and shale which they sold. (App. A, *infra*, pp. 26-27.)[4]

The District Court held that the taxpayer is entitled to take depletion on the total sales ($1,409,145.66) of its finished manufactured products, such as sewer pipe. (R. 6-7.) The Court of Appeals affirmed. Noting that taxpayer's costs are such that it could not profitably sell raw fire clay and shale, the court concluded that taxpayer has a different commercially marketable product than non-integrated members of the same mining industry and that it may take mineral depletion on the basis of the gross proceeds received from sale of its factory output. (App. A, *infra*, pp. 21-31.)

REASONS FOR GRANTING THE WRIT

1. The question presented is one which affects in very substantial degree the tax liabilities and the competitive situation of thousands of miners and miner-manufacturers. In our view, this is one of the most important tax cases presented to this Court in recent years.[5] The reasons which prompt this assertion may be stated as follows:

A. The issue decided by the court below is fundamental to the administration of the revenue provi-

[4] Directly across the river from taxpayer (in Kentucky), raw fire clay and shale were sold in substantial quantities to another sewer pipe manufacturer. (See R. 201-228.)

[5] The issue is discrete from that raised by the Government's petition in *United States* v. *Merry Brothers Brick & Tile Co.*, October Term, 1957, No. 220, certiorari denied, 355 U. S. 824. The relationship to that case is discussed *infra*, pp. 12-14.

sions relating to mineral depletion. What is at stake is ultimately this—May the deduction for depletion of mineral deposits, adopted on the theory that there should be an allowance for the exhaustion of a wasting asset, be converted into a prodigious tax benefit, available to selected taxpayers, for their *manufacturing* activities? The court has adopted a construction of the statute [6] which affords miner-manufacturers an opportunity to take extremely large deductions—in many instances, five, ten, and fifteen times what might otherwise be claimed [7]—which are not avail-

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[6] In *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398 (C.A. 8th), the Eighth Circuit subscribed to the same view of the statute. However, since that decision also rests on an independent ground (see p. 14, note, *infra*), we are not filing a petition in the *Iowa Limestone* case.

The decision below has also been followed by three District Courts. See *Standard Clay Manufacturing Co.* v. *United States* (W.D. Pa.), decided July 8, 1959 (4 A.F.T.R. 2d 5241), pending in the Third Circuit; *Dixie Fire Brick Co.* v. *United States* (N.D. Ala.), decided July 30, 1959 (4 A.F.T.R. 2d 5368), pending in the Fifth Circuit; *Victorville Lime Rock Co.* v. *Riddell* (S.D. Cal.), decided July 27, 1959 (4 A.F.T.R. 2d 5463), pending in the Ninth Circuit.

Three other cases are now pending on Government appeals to two other circuits: *Sparta Ceramic Co.* v. *United States*, 168 F. Supp. 401 (N.D. Ohio), pending in the Sixth Circuit; *Pacific Clay Products* v. *United States* (S.D. Cal.), decided October 30, 1958 (3 A.F.T.R. 2d 873), pending in the Ninth Circuit; *California Portland Cement Co.* v. *Riddell* (S.D. Cal.), decided November 21, 1958 (3 A.F.T.R. 2d 438), pending in the Ninth Circuit. Another case is pending in the Eighth Circuit (*Centropolis Crusher Co.* v. *Bookwalter*, 168 F. Supp. 33 (W.D. Mo.)), but may be controlled by the same court's decision in *Commissioner* v. *Iowa Limestone Co.*, *supra*.

[7] See Appendix C, Table III, *infra*, p. 41. The three tables which appear in this appendix were prepared by the

able to their competitors in the same mining operations who do not engage in manufacturing. The result, we believe, is to distort beyond recognition the statutory concept of depletion for mining, and to defeat the basic Congressional purpose in granting the deduction; and the holding below is at odds (although there is no direct conflict on the precise issue involved) with decisions of this Court which define and apply that concept.

B. The impact on the revenue is enormous. The direct loss which would result if the principle declared below were applied to the 380 claims already pending administratively or in the courts[8] would amount to approximately $297,000,000.[9] But this loss would unquestionably be small as compared to the ultimate loss of revenue which may be anticipated. As a result of the decisions in the Seventh and Eighth (see note 6, *supra*) Circuits, claims for past years will doubtless multiply. And, should the holding below be followed generally; the loss for the current tax year and for future tax years is con-

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Department of the Treasury and were submitted to the House Ways and Means Committee by Mr. David A. Lindsay, then Assistant to the Secretary of the Treasury. Hearings on the Legislative Proposal Of The Treasury Department Specifying The Treatment Processes Which Shall Be Considered Mining For The Purpose Of Computing Percentage Depletion In The Case Of Mineral Products, 86th Cong., 1st Sess., pp. 11-13. As to the purposes of the Treasury's legislative proposal, see note 19, p. 14, *infra*.

[8] Litigation is now pending in over 100 cases.

[9] Appendix C, Table I, p. 39, *infra*.

servatively estimated by the Treasury Department at approximately $598,000,000 per annum.[10]

C. No less important than the effect upon the federal revenue is the impact that the decision will have upon our competitive economy. The tax benefits to certain miner-manufacturers will be enormous for they will be enabled, like the taxpayer in this case, to take mineral depletion upon the basis of the price of an expensive, manufactured product. Competitors will suffer discrimination.

(1) Competing miner-manufacturers, utilizing the identical minerals in their products, will be required to take depletion on the basis of a more primitive product because, so far as they are concerned, it may be demonstrable that they can (or do) profitably sell such a product. *Example*: Two producers, A and B, mine iron ore and convert it into pig iron. Two tons of iron ore, for which the market price is approximately $16.00, can be processed into one ton of pig iron, which commands a price of approximately $60.00. A, who has a low-cost mine and an efficient operation, sells iron ore *and* pig iron, both at a profit. B, who has a high-cost mine, cannot compete in the iron ore market, but does profitably sell pig iron. On these facts, the decision below means that A's depletion allowance for two tons of iron ore is 15 percent of $16.00 ($2.40) and B's allowance is 15 percent of $60.00 ($9.00). Thus, B, whose mine is high-cost and hence worth *less* than A's, obtains, as compensation for exhaustion of

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[10] Appendix C, Table II, p. 40, *infra*.

his mineral deposit, an allowance per ton which is almost four times that received by A.[11]

(2) Manufacturers who compete with favored miner-manufacturers will be at a serious disadvantage. As the above example indicates, a miner-manufacturer who obtains depletion on the basis of a costly finished product receives what is in substance a sizable manufacturing subsidy. On the other hand, a processor of iron ore who purchases the ore from an independent source receives none.

(3) There will be widespread and gross discrimination as between integrated and non-integrated miners. *Example: This case.* Taxpayer mines fire clay and shale. It does not sell it as such (although, as the court below found, there is "a substantial market for fire clay and shale" (App. A, *infra*, p. 23)) because of its "prohibitively high mining and transportation costs". (*Ibid.*) Instead, it uses the mineral to produce vitrified sewer pipe and certain other expensive products. Computing its depletion allowance on the basis of gross income from its sales of sewer pipe, etc., it obtains depletion allowances on fire clay and shale amounting to *$4.03* per ton.[12] Directly across the river from taxpayer,

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[11] This, of course, is not the outside limit. If B's economic situation were such that he could not profitably market pig iron, presumably he might claim depletion based on the sales price of a still more advanced product, *e.g.*, structural steel.

[12] The depletion rate for fire clay is 15 percent and that for shale 5 percent. Thus, on the basis of taxpayer's sales (during the taxable year) of $1,409,145.66 and the use

a miner extracted fire clay and shale (in the same taxable year) and delivered it to a local manufacturer for approximately *$1.40* a ton.[13] Taxpayer's theory, accepted by the decision below, yields it a depletion allowance (per ton) amounting to 288 percent of the *price* at which it could have bought the same quantity of mineral on the market.[14] What, by contrast, is the depletion allowance to which a non-integrated miner selling fire clay and shale at $1.40 per ton would be entitled? The answer: approximately *15 cents* per ton.[15] We submit that the tax laws, if construed to permit this kind of result,

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therein of 38,473 tons of fire clay and shale (60 percent of which was fire clay and 40 percent shale), taxpayer's depletion allowance would be computed as follows under the decision below:

$1,409,145.66 × 60% ÷ 23,084 × 15% = $5.49
(Depletion allowance per ton of fire clay)

$1,409,145.66 × 40% ÷ 15,389 × 5% = $1.83
(Depletion allowance per ton of shale)

Depletion allowance for one ton of mineral consisting of 60% fire clay and 40% shale ($5.49 × 60% plus $1.83 × 40%) = $4.03

[13] See R. 48, 205-212.

[14] As noted under (2), immediately above, a sewer pipe manufacturer who bought fire clay and shale on the open market would not be entitled to any allowance.

[15] Using the same 60-40 proportions in which taxpayer mined fire clay and shale, the depletion allowance is computed as follows:

60% of $1.40 × 15% + 40% of $1.40 × 5% = $.154

may well create an almost irresistible impulse to vertical integration.[16]

D. The rule adopted below is one which creates virtually insuperable administrative problems, although Congress was seeking "a simple, practical rule".[17] Under the decision below, the Commissioner is not authorized to determine the first (cheapest and most primitive) commercially marketable product made by the branch of the mining industry concerned. Rather, he must determine, each year, what products each integrated miner-manufacturer in the United States can, with the particular processes he applies and in the light of his individual facilities

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[16] Similar illustrations can be given for this and other branches of the mineral industry:

Another integrated miner-manufacturer who mines and uses fire clay and shale to make bathroom and floor tile is claiming depletion on the $169.00 it realized per ton of clay, which is over 50 times the depletion base of a non-integrated clay miner in the same area. *Sparta Ceramic Co.* v. *United States*, 168 F. Supp. 401 (N.D. Ohio), pending in the Sixth Circuit.

A company which mines salt, for which the sales price is about $10 a ton in bulk, is claiming depletion on the sales prices of the salt in the various forms in which it is marketed, including 4 oz. containers selling at about $1,800 a ton. *Morton Salt Co.* v. *United States* (C. Cl., No. 142-58).

A gypsum company which has succeeded in establishing that gypsum is to be deemed "stone" for depletion purposes (*U.S. Gypsum Co.* v. *United States*, 253 F. 2d 738 (C.A. 7th)), is now pressing a claim that the allowance on its "stone" is to be computed on the basis of the proceeds received from sale of manufactured wall board. ~~*Id.*, N.D. Ill., Civ. No. 53 811.~~

[17] *United States* v. *Merry Brothers Brick & Tile Co.*, 242 F. 2d 708, 711-712 (C.A. 5th); certiorari denied, 355 U.S. 824.

and costs, sell at a profit. The difficulties of such investigation and prognosis (involving technology, cost accounting, market conditions, etc.) are so formidable that in most instances the Commissioner, as a practical matter, would have no choice but to presume that the finished products actually manufactured by an integrated producer are the only ones which he could profitably market.

2. The decision below plainly misconstrues the controlling statutory provision and destroys the fundamental theory of the depletion allowance.

A. At the outset, it may be noted that, although the statutory provision in question is the same one which was involved in *United States* v. *Merry Brothers Brick & Tile Co., et al.*, October Term 1957, No. 220, certiorari denied, 355 U. S. 824, the issue is entirely distinct.

The depletion allowance is set forth in terms of a stated percentage of the gross income from mining (Section 114(b)(4)(A), (B), App. B, *infra*, pp. 33-36). The statute then defines "mining" to include "not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *" (Section 114(b)(4)(B). This poses two problems: (1) What is included in the phrase "ordinary treatment processes"? (2) How does one determine the identity of the "commercially marketable mineral product"? The first question was involved in the prior set of appellate decisions which led to the filing of a petition for

certiorari in *Merry Brothers*.[18] The second question is presented here.

The issue litigated in *Merry Brothers* and companion cases may be briefly restated. The mine operators involved in those cases extracted brick and tile clay (to be distinguished from fire clay) and made it into brick. It was admitted or assumed that there was no commercial market for brick and tile clay as such. The question therefore was whether all of the various processes used in making clay into brick were "ordinary treatment processes" in the statutory sense. The Government's view was that this statutory term, read in light of the legislative history and prior administrative construction, had a gloss; that it covered only certain treatment processes—principally, purification and concentration processes—which were related to mining, though performed after the mineral had gone beyond the mouth of the mine; and that the term did not cover those processes which, though they were necessary for purposes of obtaining the marketable product, were essentially related to manufacturing rather than mining.

If that view had been accepted by the courts, the issue now presented would not have large importance.

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[18] At the same time, a petition for certiorari was also filed in *United States* v. *Dragon Cement Co., Inc.*, October Term 1957, No. 301, certiorari denied, 355 U. S. 833, which was the same in all relevant aspects. Other cases which involved the issue presented in *Merry Brothers* and *Dragon Cement* were *United States* v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 (C.A. 5th); *Townsend* v. *Hitchcock Corp.*, 232 F. 2d 444 (C.A. 4th); *United States* v. *Sapulpa Brick & Tile Corp.*, 239 F. 2d 694 (C.A. 10th).

for it would have been established that in all events manufacturing processes are not includable in gross income from mining. The Government's view of the scope of "ordinary treatment processes" was not accepted by the appellate courts.[19] As a result, it becomes of great importance to ascertain whether the term "commercially marketable mineral product" refers to the basic product marketed in the relevant branch of the mining industry (as the Government here contends) or whether (as held below) it permits each miner-manufacturer to claim depletion on the basis of the finished product which that manufacturer, in his particular operation, finds it profitable to make. This question, as the court below recognized (App. A, *infra*, pp. 24-25), is distinct from the issue litigated in the *Merry Brothers* type of case.[20]

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[19] At the last session of Congress, the Government proposed legislation which would specify for all minerals the processes which shall be treated as mining for the purpose of computing the amount of gross income derived from mineral extraction. The House Ways and Means Committee conducted hearings (see p. 7, note 7, *supra*) but has taken no further action to date.

[20] In *Commissioner* v. *Iowa Limestone Co.*, 269 F.2d 398, the Eighth Circuit agreed with the Seventh Circuit's conclusion that the courts are to ascertain the product which the individual taxpayer can profitably sell, and it allowed the taxpayer to take depletion on the basis of *pulverized* chemical grade limestone rather than on the basis of such limestone in *crushed* form. But the court also determined that chemical grade limestone in crushed form is not a marketable product. Although we believe that this determination was contrary to the evidence, we have concluded that the case is not an appropriate one for certiorari

B. The decision below cannot be squared with the statutory language. The statute speaks of the "*ordinary* treatment processes *normally* applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." It cannot be ordinary or normal for miners of fire clay—itself, a marketable product—to apply those processes which are used by manufacturers of sewer pipe; miners of fire clay are not ordinarily sewer pipe manufacturers. If the reference to "ordinary treatment processes normally applied by mine owners" was not designed to confine the depletion allowance to processes functionally related to mining—the view adopted by the Courts of Appeals in *Merry Brothers* and similar cases—there is only one possibility left, unless the statutory language is to be ignored: That Congress, at the least, meant to confine the allowance to the basic product sold by the particular mining industry.[21] The concept of ordinary processes

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because (1) the record on marketability is not well developed and (2) review would require this Court to re-evaluate an essentially factual issue.

[21] There is ordinarily no difficulty in designating the basic (least processed) marketable product derived from a particular mineral. The subject, in any event, lends itself readily to expert determination and to statement in appropriate regulations. It would, of course, remain necessary, in the event that a particular miner-manufacturer did not sell the mineral product in its least processed state, to prorate that operator's income. The pertinent Treasury Regulations have long provided the formulae for making that determination. See the Treasury Regulations applicable to the taxable year involved here (App. B, *infra*, pp. 36-38) and Treasury Regulations 77, Article 221.

The court below took the position that the individual tax-

normally applied by mine owners certainly must exclude the possibility that ten miner-manufacturers making ten different finished products from the same mineral can take a depletion allowance for that mineral on ten different bases.[22]

C. Our view of the statute is strongly supported by the fundamental theory upon which the depletion allowance rests; by the precept that tax laws are to be construed, so far as possible, to achieve a measure of uniformity; and by the history of the legislation.

This Court recently observed (*Parsons* v. *Smith*, 359 U. S. 215, 220) that the "purpose of the deduction for depletion is plain and has been many times declared by this Court." The allowance "is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production" (*ibid.*; *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 366); it makes possible "a recoupment of the owner's capi-

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payer may ignore the first commercially marketable product of the industry if he finds it unprofitable to market it in that form. But compare the holding of the Fifth Circuit in *Alabama By-Products Corp.* v. *Patterson*, 258 F. 2d 892, certiorari denied, 358 U. S. 930.

[22] Taxpayer can draw no comfort from the fact that the statute speaks of the processes used to obtain the "commercially marketable mineral product *or products*." The plural usage is but a recognition of the fact that one ore frequently yields more than one type of mineral. Section 114(b)(4)(B) explicitly recognizes this; subparagraph (iv) refers to the processes "used in the separation or extraction of the product or products from the ore * * *" (App. B, *infra*, p. 36).

tal investment in the minerals" (*Commissioner* v. *Southwest Exploration Co.*, 350 U. S. 308, 312). To be sure, to the extent that income attributable to essentially manufacturing processes comes to be included in the depletion base (the consequence of the *Merry Brothers* line of cases), an element foreign to the strict depletion concept is introduced. In *Merry Brothers*, that element, at least, was confined within determinate limits.[23] The claims for depletion which the Government currently faces are of a different order. What is involved here is not the question whether manufacturing processes are includable in the depletion base in situations where it is necessary to do some manufacturing to get the *first* commercially marketable product. What this taxpayer seeks to do is to ignore the *first* commercially marketable product (on the ground that it was not profitable for the Cannelton Sewer Pipe Company to sell fire clay) and to use the *last* marketable product (sewer pipe). As already observed, this approach makes the possibilities for "depletion" virtually limitless. In this case, which is by no means unusual or extreme as compared to other such cases (see note 16, p. 11, *supra*), the bizarre result is that a ton of fire clay assumes, for purposes of depletion, a value several times the market price of a ton of fire clay.

We have stressed the discrimination which neces-

[23] Further efforts to expand the depletion allowance were perhaps foreshadowed, even at that stage, by the fact that the Fifth Circuit's opinion suggested no distinction between the manufacture of common brick and the manufacture of more expensive varieties. See the Government's petition in *Merry Brothers*, October Term 1957, No. 220, p. 19, note 18.

sarlily results—discrimination as between different miner-manufacturers who make different products from the same mineral; as between miner-manufacturers and competing manufacturers; as between integrated mine owners and non-integrated miners (see *supra*, pp. 8-10). Certainly, it is familiar doctrine that the tax laws should be construed, where possible, to avoid, rather than create or promote, discrimination. "A cardinal principle of Congress in its tax scheme is uniformity, as far as may be." *United States v. Gilbert Associates*, 345 U. S. 361, 364.

Legislative history confirms that Congress had no intention to authorize a scheme of depletion allowance whereby the measure of the allowance would fluctuate wildly from taxpayer to taxpayer within the same branch of the mining industry—a few cents per ton, for example, for a non-integrated miner of fire clay and a few dollars a ton for an integrated operator (*supra*, pp. 9-10). On the contrary, it appears that Congress was seeking an objective standard which could be simply and uniformly applied on an industry-wide basis, *i. e.*, without regard to the individual miner's degree of integration and without regard to the particular manufactured products which he, in his individual operation, might find it profitable to make. The percentage depletion method was originally chosen by Congress for its "simplicity and certainty in administration."[24] The report

[24] See S. Rep. No. 52, 69th Cong., 1st Sess., pp. 17-18 (1939-1 (Part 2) Cum. Bull. 332, 345-346), relating to Section 204(c)(2) of the Revenue Act of 1926, c. 27, 44 Stat. 16.

which accompanied the adoption (in 1943) of Section 114(b)(4) shows that Congress was thinking in terms of the treatment processes which would be used for each *kind* or *class* of mine.[25] It was stated further that the statutory definition of mining was "in accord with the original regulations and the Bureau practices and procedures thereunder." [26] The Regulations in question,[27] like those applicable here (App. B, *infra*, pp. 36-38), restrict the depletion base of all miners of the same mineral to the gross income from the same, single product.[28]

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[25] S. Rep. No. 627, 78th Cong., 1st Sess., p. 23 (1944 Cum. Bull. 973, 991).

[26] S. Rep. No. 627, *supra*, pp. 23-24 (1944 Cum. Bull. at 992).

[27] Treasury Regulations 77, Article 221.

[28] We also note that when the chief representative of the refractories industry requested Congress to add fire clay and certain other minerals to the list of those which would receive an allowance for depletion (a step taken by Congress in 1951), the proposal was made and explained on the assumption that the allowance would be computed on the basis of the value of the raw mineral product. See Revenue Revision of 1950, Hearings before the Committee on Ways and Means, 81st Cong., 2d Sess., pp. 453-456, 463-464.

CONCLUSION

We believe, for the reasons summarized above, that the question presented is one of great importance in the administration of the federal tax laws, warranting review by this Court. This petition for a writ of certiorari should be granted.

Respectfully submitted,

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NOVEMBER 1959

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

SEPTEMBER TERM, 1958—APRIL SESSION, 1959

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.

No. 12496

CANNELTON SEWER PIPE COMPANY,
PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

June 15, 1959

Before DUFFY, *Chief Judge*, HASTINGS and KNOCH, *Circuit Judges.*

HASTINGS, *Circuit Judge.* Taxpayer, Cannelton Sewer Pipe Company, brought this suit in the district court for a refund of income tax paid in 1951. The sole question before us is what constitutes the proper basis for the computation of percentage depletion to which taxpayer is entitled. At all times relevant to this proceeding, taxpayer was engaged, near Cannelton, Indiana, in the mining of fire clay and shale and the manufacture of vitrified clay sewer pipe and related products. Under provisions of the Internal Revenue Code of 1939,[1] taxpayer was permitted a percentage depletion on its fire clay of 15% and, on its shale, of 5% of "the gross income from the prop-

[1] Reference to "the Code" in this opinion will be to the Internal Revenue Code of 1939.

erty during the taxable year * * *." 26 U.S.C.A. § 114(b)(4)(A) (1939 I.R.C.). The district court held that taxpayer could compute its deduction for depletion on the basis of its gross income from the sale of its finished products. The Government contends such holding is erroneous.[2]

Section 114(b)(4)(B) of the Code provided, in pertinent part, that:

> "The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the *ordinary treatment processes normally applied by mine owners or operators* in order to obtain the *commercially marketable mineral product or products* * * *." (Emphasis added.)

It is taxpayer's position that the processes by which it produced vitrified sewer pipe and related products from its raw fire clay and shale qualify as "ordinary treatment processes" within the meaning of the above statutory language since it had no market for its minerals in crude form and such processes were of necessity applied by it in order to obtain the first commercially marketable products. The Government urges that, in 1951, there was an existing substantial market for raw fire clay and shale in Indiana and in the area surrounding taxpayer's mine; and, that, in light of this fact, raw fire clay and shale were taxpayer's first commercially marketable products.

Taxpayer contends that the sole question on this appeal is whether there is substantial evidence to

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[2] There was also before the trial court a question whether or not taxpayer's clay was "fire clay" but the Government has not taken issue in this appeal with the trial court's finding that taxpayer's product met the specifications of fire clay.

support the trial court's finding that vitrified sewer pipe and other finished products were taxpayer's first commercially marketable products. We do not agree that the issues are so limited. An overriding consideration is whether the trial court applied the correct legal criteria in making such a determination. The record clearly bears out the Government's assertion that there existed in Indiana, during 1951, a substantial market for fire clay and shale. At the same time, it is also apparent from the record that taxpayer could not have sold its fire clay and shale in that market *at a profit* because of prohibitively high mining and transportation costs. The question squarely presented is thus whether the statutory language which defines, as a part of "mining", "all ordinary treatment processes normally applied by mine owners" to produce "the commercially marketable mineral product or products", includes all processes necessary by a taxpayer to obtain a product *which can be sold by it at a profit*. The Government urges that "mining" includes only the processes necessary for a taxpayer to produce a product which, with the least processing, is "marketable", *i.e.*, for which there is a market; and that it is not material whether or not it is economically feasible for a taxpayer to sell in that market. This theory presupposes that there would be a marketable or "depletable" product for each raw or crude mineral, and that the depletion allowance would be computed on this marketable or depletable product.[3]

[3] Section 29.23(m)-1(f) of Treasury Regulations 111 provides a method for the computation of the gross income as follows:

> "If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, 'gross income from the property' means the amount for

The Government has attempted, in a number of cases and with conspicuous lack of success, to limit the scope of the definition of mining contained in Section 114(b)(4)(B) here before us. Courts of Appeals in four different federal judicial circuits have uniformly and unhesitatingly rejected such endeavors to narrow the application of the provision's language. In *United States* v. *Cherokee Brick & Tile Company*, 5 Cir., 218 F. 2d 424 (1955) the Government urged unsuccessfully that since burnt brick and tile were *manufactured* rather than *mineral* products, the processes by which raw brick and tile clay were transformed into burnt brick and tile could be no part of mining for depletion purposes. The Court of Appeals for the Fifth Circuit held that the processes used to produce the burnt brick and tile were the ordinary treatment processes needed to produce the first commercially marketable products. That court has since reaffirmed its holding in the *Cherokee* case

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which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, 'gross income from the property' means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. * * *"

in *United States* v. *Merry Brothers Brick & Tile Company*, 5 Cir., 242 F. 2d 708 (1957) and, indeed, therein expressly rejected the Government's request that, upon reconsideration and re-examination, it should reverse its previous ruling. The Court of Appeals for the Tenth Circuit, citing the *Cherokee* case, similarly held against the Government in a case also involving brick and tile clay. *United States* v. *Sapulpa Brick and Tile Corporation*, 10 Cir., 239 F. 2d 694 (1956). In *Dragon Cement Company* v. *United States*, 1 Cir., 244 F. 2d 513 (1957), the Government contended that cement was a manufactured product which was chemically different in composition from the depletable product, cement rock, and that, therefore, the taxpayer could not use the gross income from sale of cement as its basis for computing percentage depletion. This was rejected by the Court of Appeals for the First Circuit. Finally, in *Townsend* v. *The Hitchcock Corporation*, 4 Cir., 232 F. 2d 444 (1956), it was held that the grinding and bagging of talc and the cutting of talc into crayons were ordinary treatment processes by which mine owners obtained the commercially marketable products, even though the final products were manufactured.

In all the above cases, the Government's basic contention was that manufacturing processes could not be "ordinary treatment processes" within the meaning of the Code. Likewise, in each of these cases, the Government readily admitted that each taxpayer had no market, or a market for only a negligible quantity, of the particular raw mineral involved; but urged that this fact was of no consequence since the overriding consideration was that depletion could not be allowed on the sale of manufactured products.

That argument has definitely been laid to rest; the Government has not renewed it before this court.

The courts in the above cases uniformly held that the prime consideration was whether taxpayer applied the normal processes necessary to produce the first commercially marketable product, even though what are usually considered manufacturing processes were applied; and the question was treated as one of fact.[4]

The Government contends that the trial court misinterpreted the above cases as holding that a taxpayer could take depletion on its finished product regardless of whether it was the first commercially marketable product. As it points out, in this case it did not admit the nonmarketability of fire clay and shale. Indeed, the Government's evidence indicates that large quantities of fire clay and shale were sold during the tax year, 1951. Thus, in Indiana, of 82 companies engaged in the production or consumption of fire clay and shale, 32 purchased fire clay or shale, or both, for use in their manufacturing operations. Seven producers of fire clay and two producers of shale in Indiana engaged in nonintegrated operations, that is, strictly in the extraction of the raw fire clay and shale and not in further processing.

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[4] The Court of Appeals for the Fifth Circuit stated in *United States* v. *Cherokee Brick & Tile Company*, *supra* at 425, that:

> "* * * [T]he crucial point in this case is one of fact, not of law; and the pleadings admit that fact to be against the Government.
>
> * * *
>
> "The complaint alleges that, of the brick and tile clay mined in the United States, there is opportunity for the sale of only a negligible quantity before it is put into the form of burnt brick and tile. This allegation is admitted in the answer of the appellant. For this and other reasons (but mainly for this one) stated in the opinion of the district court, * * * the judgment appealed from should be affirmed."

These companies necessarily took depletion on the raw fire clay and shale which they sold. Taxpayer's own expert witness, Haydn H. Murray, admitted, on cross-examination, that over 300,000 short tons of fire clay (of some 500,000 short tons produced) were sold in Indiana in 1951 rather than used by the producer in integrated manufacturing operations.

The taxpayer points out that a good percentage of the clay and shale, actually sold, was sold in the Brazil, Indiana area at prices ranging from $1.60 to $1.90 per ton delivered in the Brazil area. Taxpayer's mining costs alone, ignoring for the moment the transportation costs which would be an added expense if it sought to sell its raw clay and shale, amounted to $2.41 per ton. Those companies selling fire clay in Indiana concerning which the Government introduced evidence fall into two categories. There are those operators who engage primarily in strip mining of coal and, who, during their operations, strip bare so-called underclay which they sell as a by-product. Secondly, there are those which mine underclay which has already been laid bare by previous strip mining operations. The mining costs of such operators would be considerably below those of taxpayer which operated an underground mine. Further, several of the operators of those mines discussed above could not find a market for all the clay which they had available for sale.

We agree with the taxpayer that it did not have a *commercially* marketable product in its fire clay and shale. We are unable to accept the theory that a taxpayer's depletion allowance is to be computed on the basis of a representative market or field price for a product which taxpayer could not sell at a profit. To do so would be to deprive of all meaning the words "commercially marketable" as used in the

Code provision here considered.[5] The integrated operations of taxpayer in this case (that is, combined mining and manufacture) were certainly not unique. The evidence the Government used to establish the existence of a market for taxpayer's fire clay indicates, in fact, that the integrated miner-manufacturer was the rule rather than the exception in Indiana, in 1951. The fact that certain operators of strip mines found it economically feasible to extract

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[5] In *Arvonia-Buckingham Slate Company* v. *United States*, D.C. E.D. Va., 167 F. Supp. 903 (1958) the district court was faced with and rejected the contention that taxpayer involved had a marketable product in unprocessed slate even though the record showed that it was economically unfeasible for taxpayer to mine slate suitable for sale at a profit until it processed the slate into roofing slate shingles. The nature of the seam which taxpayer worked made it necessary for it to blast the slate free and the waste slate, consisting of pieces unsuitable for shingles, sold for only ten cents a ton. In *Riverton Lime and Stone Co*, v. *Commissioner of Internal Revenue*, 28 T.C. 446, 448 (1957) the Tax Court held that hydrated limestone was taxpayer's first commercially marketable product for [w]hile it may have been possible to use petitioner's limestone in its quarried state for agricultural purposes, petitioner could not, and did not, sell it in this market because of the abundance of other limestone in the area which was chemically more suited to the farmers' needs." The Government points out in its brief that appeals are now pending from similar adverse holdings in the following cases: *Iowa Limestone Co.* v. *Commissioner*, 28 T.C. 881 (1957), now pending on appeal to the Eighth Circuit and involving the question of whether crushed rather than pulverized limestone is a taxpayer's first commercially marketable product; *Sparta Ceramic Company* v. *United States*, D.C.N.D. Ohio, 168 F. Supp. 401 (1958), on appeal to the Sixth Circuit and involving fire clay; and *Pacific Clay Products* v. *United States*, (S.D. Calif.), decided October 30, 1958, on appeal to the Ninth Circuit and involving both fire clay and brick and tile clay.

and sell fire clay primarily in a limited area near Brazil, Indiana does not alter this picture. Finally, there is no contention that taxpayer applied other than ordinary treatment processes in obtaining its finished products.

In line with its theory that there must be one depletable or commercially marketable product for each mineral, the Government urges that if raw fire clay and shale are not those products for this taxpayer, this case should nevertheless be remanded for further evidence to determine if some other products could have been, with much less processing, the depletable products for this taxpayer. It is suggested that such products could be common brick and ground fire clay.[6] The short answer to this is that we do not agree that it was intended that the depletion allowance for each mineral be reduced to the common denominator represented by a conceivable product most cheaply produced from each mineral. In *United States* v. *Cherokee Brick & Tile Company*, *supra*, and *United States* v. *Sapulpa Brick and Tile Corporation*, *supra*, the Fifth and Tenth Circuits, respectively, allowed depletion on both *brick* and *tile*. In *Townsend* v. *The Hitchcock Corporation*, *supra*, both *talc powder* and *talc crayons* were treated as depletable products.

This is not to say, of course, that a product may be processed beyond the stage at which it is a commercially marketable product. In *Sparta Ceramic Co.* v. *United States*, D.C.N.D. Ohio, 168 F. Supp. 401 (1958), the district court recognized this limitation when it refused to allow depletion on the basis of gross income from sales of glazed tile rather than

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[6] There was evidence that taxpayer did sell some 80 tons of ground fire clay at a little more than twenty dollars per ton.

on the representative market price of the unglazed product. Although glazing was accomplished at the time the tile was burnt, about 65% of taxpayer's end product was unglazed and was, in fact, commercially marketable. As the court pointed out, glazing could no more be a necessary treatment process than gold plating, should taxpayer seek to enhance the value of the product by such means. As we have indicated, there is no contention here that the instant taxpayer applied other than normal treatment processes in obtaining its finished products.

The Government relies on *Riverton Lime and Stone Co.* v. *Commissioner of Internal Revenue*, 28 T.C. 446 (1957) as authority for the proposition that a small market can establish a representative market or field price for a product. However, in that case it was held merely that, although there were only a few sales of hydrated hydraulic lime in the pure state, the taxpayer could compute its gross income on the market price of that product. Most of taxpayer's sales were of an admixed product rather than a pure product and the Commissioner contended that gross income should be computed on the admixed product by the proportionate profits method[7] since the limited market for pure lime established no representative market or field price for pure lime. That case has no bearing on the problem before us since taxpayer here could not and did not sell its raw fire clay or shale prior to processing.

We find nothing in the opinion in *Alabama By-Products Corporation* v. *Patterson*, 5 Cir., 258 F. 2d 892 (1958) recently handed down by the Court of Appeals for the Fifth Circuit to indicate that that court has modified its earlier holdings in the *Chero-*

[7] See Section 29.23(m)-1(f) of Treasury Regulations 111, *supra* note 3.

kee and *Merry Brothers* cases. The court merely recognizes in footnote 12 on pages 899-900 of that opinion that neither of those cases involved a question of the existence of a representative market price since in both cases the Government had admitted nonmarketability of the crude brick and tile clay.

The decision of this court in *Zonolite Co.* v. *United States*, 7 Cir., 211 F. 2d 508 (1954) relied upon by the Government is not controlling here. In that case we held only that income received by taxpayer for transporting its mineral product from the mine to place of sale was not includible in the gross income from "mining." In other words we held that such transportation was beyond ordinary treatment processes since taxpayer's product was a commercially marketable product before such transportation costs were incurred. The holding in the instant case is entirely consistent with that decision.

The judgment of the district court is

AFFIRMED.

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* As the taxpayer points out in its brief, at the time the Government appealed from the district court's holding in the *Merry Brothers* case to the Court of Appeals for the Fifth Circuit, the Government stipulated that five other clay and shale cases should be affirmed if the court adhered to its ruling in the *Cherokee* case. Three of those involved fire clay.

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Chicago 10, Illinois
Monday, June 15, 1959

Before

Hon. F. RYAN DUFFY, Chief Judge
Hon. JOHN S. HASTINGS, Circuit Judge
Hon. WIN G. KNOCH, Circuit Judge

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.

No. 12496

CANNELTON SEWER PIPE COMPANY,
PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Indiana, Indianapolis Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, in accordance with the opinion of this Court filed this day.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

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(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * *

(b) *Basis for depletion.*—

* * * *

(4) [as amended by Sec. 145 of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 319(a) of the Revenue Act of 1951, c. 521, 65 Stat. 452] *Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.*—

(A) *In general.*—The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, *shale*, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine, 5 per centum,

* * * *

(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, borax, fuller's earth, tripoli, refractory and *fire clay*, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone, and potash, 15 per centum * * *

* * * *

of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if com-

puted without reference to this paragraph. [Italics supplied.]

(B) [as added by Sec. 124(c) of the Revenue Act of 1943, c. 63, 58 Stat. 21, and amended by Sec. 207(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906, and Sec. 304(d) of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137] *Definition of gross income from property.*—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, break-

ing, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of crude mineral product — crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 450 and 453.

* * * *

(26 U.S.C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23(m)-1 [as amended by T.D. 5413 (1944 Cum. Bull. 124) and T.D. 6004 (1953-1

Cum. Bull. 45]. DEPLETION OF MINES, OIL AND GAS WELLS, OTHER NATURAL DEPOSITS, AND TIMBER; DEPRECIATION OF IMPROVEMENTS.—

* * * *

(*f*) The term "gross income from the property," as used in sections 114(b)(3) and 114 (b)(4)(A) and sections 29.23(m)-1 to 29.23 (m)-28, inclusive, means the following:

* * * *

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. For a description of transportation

which is treated, for taxable years beginning after December 31, 1949, as mining, see the preceding paragraph and section 114(b)(4)(B), as amended.

* * * * *

APPENDIX C

TABLE 1

Total potential tax loss resulting from the extension of percentage depletion to manufactured products as reflected in cases currently in litigation or pending administratively

Mineral	Number of cases	Potential tax loss										
		Total	Unallocable by year	Allocable by year	1951	1952	1953	1954	1955	1956	1957	1958
Asbestos	1	(1)										
Bentonite	4	422,255	98,115	324,140	62,000	25,617	36,185	50,579	90,335	37,653	21,771	
Clay, brick & tile	80	14,428,395	1,031,819	13,396,576	1,111,190	1,062,302	1,575,466	3,139,458	2,339,058	2,609,043	1,458,302	101,757
Clay, brick and tile shale	2	27,639		27,639					9,294	9,732	7,925	688
Clay, fire	50	19,405,252	2,408,025	16,997,227	2,792,559	1,748,224	2,337,376	2,123,863	3,154,148	3,153,666	1,606,233	81,158
Clay, fire - brick and tile shale	10	1,843,887	39,746	1,804,141	208,215	166,065	185,800	271,989	319,800	375,276	276,996	
Coal	12	612,088	443,873	168,215			60,727	50,433	.....	28,992	27,511	552
Coal & Iron ore	2	9,566,675	.....	9,566,675	4,403,923 [2]	2,995,769	2,166,983	.....	.....	.....	.....	.....
Diaspore	1	(1)										
Diatomaceous earth	2	(1)										
Dimension stone	2	37,819		37,819					24,958	12,861	.....	.....
Dolomite	7	3,609,963	142,994	3,466,969	877,776	757,999	656,555	540,189	206,150	352,150	76,150	.....
Gilsonite	1	(1)										
Granite	7	506,511	191,000	315,511	37,285	86,229	51,666	63,316	44,439	15,696	16,880	.....
Gypsum	4	8,895,242	280,969	8,614,273	.....	.....	23,757	8,330,346	260,170	.....	.....	.....
Limestone	90	111,069,905	3,336,467	107,733,438	14,848,674	12,325,263	13,935,364	16,806,371	17,277,448	14,686,074	16,034,552	1,819,692
Limestone - clay/shale	22	84,567,281	2,694,463	81,872,818	8,124,905	12,326,284	12,507,148	12,575,815	15,122,815	11,540,485	9,455,366	220,000
Limestone and dolomite	4	881,728	881,728									
Oil and gas	6	1,476,789	18,845	1,457,944	.....	99,641	65,666	142,497	340,047	396,598	413,495	.....
Quartzite	8	1,583,374	473,296	1,110,078	95,921	315,893	132,881	225,673	197,346	65,677	68,220	8,469
Rare minerals	3	527,183	.....	527,183	.....	546	678	22,548	.....	253,327	250,084	.....
Salt	14	11,186,529	208,884	10,977,645	1,495,911	1,594,561	1,662,583	1,861,120	1,858,705	1,977,855	451,910	75,000
Sand and gravel	16	640,948	92,268	548,680	12,299	126,627	165,089	126,804	103,259	48,852	750	.....
Sandstone	5	245,454		245,454	.....	55,880	59,992	66,390	32,407	21,385	9,400	.....
Shale	9	565,819	60,809	505,010	42,634	229,663	99,738	70,036	39,053	19,169	4,717	.....
Shells	2	88,656		88,656	16,095	30,052	17,800	11,481	13,228	.....	.....	.....
Stone	2	138,129	138,129									
Stone, crushed	4	847,700	538,417	309,283	35,000	67,552	68,284	72,361	66,086	.....	.....	.....
Deposits containing various minerals used in production of diverse chemical products	10	21,819,825		21,819,825	5,730,727	4,734,280	3,644,899	2,638,511	2,532,638	1,557,945	980,825	.....
Mineral items that cannot be disclosed		1,953,010	1,807,640	145,370	145,370							
TOTAL	380	296,948,056	14,887,487	282,060,569	40,040,484	38,748,445	39,454,637	49,214,738	44,019,287	37,114,575	31,161,087	2,307,316

[1] Figure withheld to avoid disclosing individual company confidential data, value included with "Mineral items that cannot be disclosed."

[2] Includes $1,736,390 allocable to 1947-1950.

TABLE II

Annual potential tax loss resulting from extension of percentage depletion to designated manufactured products for 19 mineral categories

(All dollar figures are in thousands of dollars)

Mineral	Manufactured product or products	Depletion rate on mineral	Mineral production [1] (Thousands of tons)	Value, [1] mineral	Estimated value product manufactured	Difference in value	Estimated increase in the depletion deduction [4]	Estimated tax differential [5]
Bauxite	Aluminum	23 [2]	6,743	$ 45,852	$ 716,444	$ 670,592	$ 114,001	$ 59,281
Bentonite	Clay products	15	1,571	18,415	55,245	36,830	5,524	2,872
Clay, brick & tile	Brick & Tile, Other products	5	34,385	41,316	145,306	103,790	5,190	2,699
Clay, fire	Refractory Clay products	15	11,803	53,750	208,608	154,858	23,229	12,079
Clay & shale	Cement	15 & 5 [3]	9,067	9,302	87,954	78,652	7,865	4,090
Diatomaceous Earth	Filtration, filler, insulation, misc.	15	250	2,282	7,740	5,458	819	426
Fullers Earth	Mineral oils, absorbent uses, other	15	418	8,879	13,318	4,439	666	346
Granite	Building stone	15	29,636	65,447	229,065	163,618	24,543	12,762
Gypsum	Building board and plaster	15	14,652	41,913	321,652	279,739	41,961	21,820
Iron ore	Steel	15	96,730	749,657	4,804,450	4,054,793	608,219	316,274
Kaolin	Paper filling & coating, other	15	2,250	34,504	51,756	17,252	2,588	1,346
Limestone	Cement	15	81,008	85,230	785,774	700,544	105,082	54,643
Limestone	Lime	15	10,577	14,660	135,727	121,067	18,160	9,443
Salt	Chlorine, Soda ash	10	14,565	45,876	339,994	294,118	29,412	15,294
Sand & Gravel	Road construction	5	624,697	595,161	3,570,606	2,975,505	148,775	77,363
Sandstone	Finished stone	15	13,447	33,998	46,388	12,390	1,858	966
Marl, slag, gypsum, etc.	Cement	5	11,901	11,901	115,440	103,539	5,177	2,692
Stone	Rough construction	5	62,925	109,339	218,678	109,339	5,467	2,843
Talc	Ceramics, Paints, filler, insectidites, other	15	739	4,859	15,026	10,167	1,525	793
Total							$1,150,061	$598,032

Note: Coal, Petroleum, Gas, and various other minerals are not represented because of insufficient data from which comparable statistics could be estimated.

[1] Production and crude value figures are either taken directly or derived from figures in the U. S. Bureau of Mines 1956 Mineral Yearbook.

[2] 23 percent is the depletion rate for the domestic production of bauxite. An assumed depletion rate of 17 percent is used to compute the estimated increase in depletion deduction. This is because approximately 70 percent of mined bauxite used in aluminum production is produced by U. S. manufacturers in the Caribbean area and subject to a depletion rate of 15 percent.

[3] It is assumed that equal tonnage of clay and shale is used in the production of cement; therefore, a 10 percent depletion rate is used to determine the estimated increase in depletion deduction.

[4] The figure for "Estimated Increase in Depletion Deduction" assumes that the net income limitation does not apply.

[5] The figure for "Estimated Tax Differential" assumes a corporate tax rate of 52 percent.

TABLE III

Claims of individual companies illustrating potential tax loss resulting from extension of percentage depletion to manufactured products

Mineral Deposit	Mineral Form Claimed for Depletion Purposes by Taxpayer	Year or Years Involved	Percentage Depletion Computed by Government	Percentage Depletion Computed by Taxpayer	Percent - Taxpayer to Government	Tax Differential
Bauxite	Aluminum Sulfate (Alum)	Unknown	$ 35,000	$ 232,420	664	$ 102,600
Bentonite	Caulking Clay	Unknown	39,600	95,400	241	29,000
	Caulking Clay	Unknown	31,700	109,600	346	40,500
Clay, Brick and Tile	Brick & Tile Products	1951-1956	59,359	523,931	883	240,345
	Brick & Tile Products	1951-1954	23,953	175,525	733	97,953
Clay, Fire	Fire Brick, Mortar	1953-1956	2,250,000	9,339,545	415	4,468,168
	Fire Brick, Structural Brick	1951-1953	350,000	1,773,291	507	717,220
Clay, Fire and Shale	Various Clay Products	1951-1954	44,019	537,779	1222	250,871
	Various Clay Products	1951-1953	9,786	123,720	1264	66,700
Coking Coal	Coke & By-products	Unknown	140,700	258,000	183	83,100
Dolomite	Refractory Brick, Ground Dolomite	1955-1956	312,459	844,485	270	276,549
Fullers Earth	Uncertain, Mineral Primarily Used as an Absorbent or as Rotary Drilling Mud	Unknown	214,723	344,148	160	67,300
Granite	Building Stone	1951-1957	96,375	438,525	455	177,907
	Monuments	Unknown	36,173	106,553	295	36,000
Gypsum	Wallboard, Plaster, & other Construction Uses	Unknown	2,125,000	12,815,000	603	6,783,900
Iron Ore	Steel	Unknown	2,000,448	12,002,688	600	5,001,165
Limestone	Lime	1953-1957	106,231	377,230	327	106,231
	Limestone & Chemical Plant (Specific Product Unknown)	1951-1953	8,064,000	37,680,000	467	19,268,000
Limestone	Cement	3 years	1,983,500	9,450,000	476	5,353,730
	Cement	1953-1956	919,923	2,931,060	319	1,045,790
Limestone & Shale/Clay	Cement	1951-1954	3,201,678	13,702,811	428	5,760,968
	Cement	1951-1955	1,506,248	4,009,901	266	1,020,192
Perlite	Abrasives & Aggregates	Unknown	2,570	15,527	604	3,535
Quartzite	Silica	1954-1955	169,035	711,523	421	288,175
Salt Brine	Chlorine & Caustic Soda	3 years	857,874	11,555,640	1347	6,633,876
	Salt & Salt Products	4 years	1,770,498	8,290,912	468	3,260,207
Sandstone	Silica Products	1951-1955	70,169	243,923	348	111,181
Sand & Gravel	Construction Use	1953-1955	7,750	62,069	801	28,540
	Construction Use	1953-1955	10,315	93,935	911	43,763
Shale	Tile	1951-1954	11,805	214,585	1818	104,827
Shells, Oyster/Clam, Etc.	Road Construction	1951-1953	78,612	171,620	218	63,962
Solite	Light-weight Aggregate	Unknown	100,000	312,000	312	114,000
	Light-weight Aggregate	Unknown	8,080	26,779	331	8,725
Stone, Crushed	Rough Construction	3 years	1,730,484	3,508,283	203	924,500
	Rough Construction	2 years	8,667	43,595	503	17,500

March 3, 1959

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959

No. 513

UNITED STATES OF AMERICA,
Petitioner,

vs.

CANNELTON SEWER PIPE COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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BRIEF FOR RESPONDENT IN OPPOSITION

QUESTION PRESENTED

The sole issue in this case is the basis for computing the percentage depletion allowance to which the taxpayer is entitled under the provisions of the Internal Revenue Code of 1939 because of the taxpayer's mining and processing of clay. Under the provisions of the Code, taxpayer's percentage depletion deduction is to be computed as a percentage of "gross income from the property" which the Code

specifically defines as "gross income from mining". The allowance, however, may not exceed "50 per centum of the net income . . . from the property". The Code[1] then specifically broadens the meaning of "mining" as generally understood;

> "The term 'mining' as used herein shall be considered to include *not merely* the extraction of the ores or minerals from the ground *but also* the ordinary treatment processes normally applied by mine owners or operators in order to obtain the *commercially marketable mineral product or products* . . ." (Emphasis supplied)

The taxpayer produced burnt clay products (principally vitrified clay sewer pipe) from fire clay and shale which it mined from its underground mine. The taxpayer sold no raw fire clay or shale, nor could it have done so.

The question presented is whether the gross income from the sale of the finished commercially marketable products sold by the taxpayer is the proper base for computation of the percentage depletion allowance or whether that base must be a hypothetical gross income ascribed to raw clay which taxpayer could not commercially market.

STATEMENT

Taxpayer, Cannelton Sewer Pipe Company, was engaged near Cannelton, Indiana in mining from an underground mine fire clay and shale during 1951, the taxable year in suit, and taxpayer mined 38,473 tons of clay, in the proportions of 60% fire clay and 40% shale, all of which it processed into vitrified clay sewer pipe and related burnt clay

[1] Internal Revenue Code of 1939, Section 114(b)(4)(B), set forth in the petition, p. 33.

products, except for a negligible 80 tons of ground fire clay and shale which it sold in bags. (R. 5)

At no time did taxpayer ever sell any of its raw fire clay or shale nor has it ever purchased any fire clay or shale for use in its production of said products; there was no market for the fire clay and shale mined by taxpayer before it was processed into said products, except for negligible amounts of ground fire clay and shale. (R. 5, 6) As the Court below held, the first commercially marketable mineral products of the fire clay and shale mined by plaintiff during the year in question were its said burnt clay products. (R. 6)

The Court below found (R. 5) and the Court of Appeals recognized that "there is no contention here that the instant taxpayer applied other than normal treatment processes in obtaining its finished products."

The Circuit Court found that at Brazil, Indiana, 140 miles away from the taxpayer, substantial quantities of fire clay were sold during the taxable year, 1951, either by strip-miners of coal who sold the underclay as a by-product or by those who mined underclay which had already been laid bare by coal strip-mining operations. The Court pointed out, however, that of 82 companies in Indiana who mined or used fire clay or shale, only 7 miners of fire clay and 2 miners of shale sold the clay in the raw form rather than processing it into finished clay products and that "The evidence the Government used to establish the existence of a market for taxpayer's fire clay indicates, in fact, that the integrated miner-manufacturer was the rule rather than the exception in Indiana, in 1951." (Pet. App. A, p. 28). The Court also pointed out that the mining costs of strip-miners was considerably less than those of taxpayer who operated an underground mine, and that several of the miners at

Brazil could not find a market for all of the clay which they had available for sale.

The raw fire clay sold at Brazil, Indiana ranged from $1.60 to $1.90 per ton delivered in the Brazil area. Taxpayer's mining cost alone was $2.41 per ton. But even if taxpayer could have mined its clay for nothing, the evidence showed that the transportation cost alone for hauling taxpayer's clay to Brazil was $4.58 per ton by rail freight and from $5.50 to $6.00 per ton in taxpayer's experience (R. 119, 120) to $15.20 per ton in the experience of one of the Government witnesses if hauled by truck (R. 283). This transportation cost eliminated Brazil completely as a commercial market for taxpayer's fire clay and shale.[2]

On the basis of these facts, the Court of Appeals concluded (Pet., App. A p. 27): "that it (taxpayer) did not have a *commercially* marketable product in its fire clay and shale", and that it was entitled to compute its percentage depletion allowance on the basis of its selling price of its burnt clay products.

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[2] In Footnote 4 at page 5 of the Government's petition, it is stated that raw fire clay and shale were sold across the river from taxpayer in Kentucky. This statement refers only to the fact that one Frank Chapman had a contract with a manufacturer of sewer pipe to mine and haul fire clay and shale from lands owned by the manufacturer at a contract price per ton. The witness stated unequivocally that he had never sold any raw clay and he knew of no one in that area who did mine and sell raw clay. (R. 225)

ARGUMENT

I

There is no conflict among Circuit Courts of Appeal as to the decision in this case.

Taxpayers have prevailed in six Circuit Courts of Appeal[3] in regard to the construction of the statutory language involved in Section 114 (b)(4)(A) and (B) of the 1939 Code. There has been no conflict among the decisions by such courts, and no claim of any such conflict is made by the Government in its petition in this case.

II

The Government's petition presents no important question of Federal law which needs to be decided by this Court.

The question in this case is solely one of statutory construction. The same statutory language has been construed by six Circuit Courts of Appeal. Seven Circuit Court opinions have been written, with a total of twenty judges participating. There has not been a single dissent.

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[3] *United States* v. *Cherokee Brick & Tile Company*, 218 F. 2d 424 (5th Cir. 1955), as to brick and tile clay; *Townsend* v. *The Hitchcock Corporation*, 232 F. 2d 444 (4th Cir. 1956), as to pulverized talc and talc crayons; *United States* v. *Sapulpa Brick & Tile Corporation*, 239 F. 2d 694 (10th Cir. 1956), as to brick and tile clay; *Dragon Cement Company, Inc.* v. *United States*, 244 F. 2d 513 (1st Cir. 1957), cert. denied 355 U.S. 833, as to cement rock; *United States* v. *Merry Brothers Brick & Tile Co.*, 242 F. 2d 708 (5th Cir. 1957) cert. denied 355 U.S. 824; as to brick and tile clay; *United States* v. *Cannelton Sewer Pipe Co.*, 268 F. 2d 334 (7th Cir. 1959), as to fire clay and shale; *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398 (8th Cir. 1959), as to chemical grade limestone.

All of these courts have held that the statute is "clear and unambiguous". All of the arguments made by the Government in an attempt to restrict the plain meaning of the statute have been carefully considered and rejected. Since the decision was made in the instant case, the opinion of the 7th Circuit Court of Appeals has been considered and approved by the Court of Appeals for the 8th Circuit in *Commissioner* v. *Iowa Limestone Company*, 269 F. 2d 368, by the Tax Court of the United States in *Halquist* v. *Commissioner*, 33 T.C. No. 36 (Nov. 25, 1959),[4] and in four District Court cases in Pennsylvania, Alabama, and California.[5] Prior thereto, the statute had been construed against the Government's theories by the Tax Court of the United States and by District Courts in nine Circuits.

Such unanimity of opinion among the scores of judges who have considered the statute certainly cannot lead to a conclusion that the issue here present can only be settled by this Court. The issue has been settled so completely that no other decision should be necessary.

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[4] On November 25, 1959, three weeks after the filing of the petition for certiorari in the present case, the Tax Court of the United States filed an opinion in the cited case which involved the same questions presented in this case. The taxpayer there mined dolomite and processed it into the products which it sold. The Court held that the gross income from these products represented the base on which the taxpayer should compute its percentage depletion and carefully considered and fully approved both the *Cannelton* and *Iowa Limestone* opinions. In view of the fact that the opinion is not yet published, we attach an excerpt from it as Appendix A, in which the statute and cases are analyzed.

[5] *Standard Clay Mfg. Co.* v. *United States*, (D.C. Pa. 1959) 59-2 U.S.T.C. 9585; *Dixie Fire Brick Co.* v. *United States*, (D.C. Ala. 1959), 59-2 U.S.T.C. 9625; *Victorville Lime Rock Co.* v. *Riddell* (D.C. Cal. 1959) 59-2 U.S.T.C. 9651; *Eastvale Clay Products Co.* v. *United States*, (D.C. Pa. 1959) 59-2 U.S.T.C. 9682.

III

The Government relies on the same grounds unsuccessfully urged in other cases where certiorari was denied.

More than two years ago, this Court denied petitions for certiorari in the cases of *United States* v. *Merry Brothers Brick and Tile Company*, et al., Oct. Term 1957 No. 220, Cert. denied 355 U.S. 824 and *United States* v. *Dragon Cement Company, Inc.*, Oct. Term 1957 No. 301, Cert. denied 355 U.S. 833. The Government makes an attempt to show that the issue present in this case is different from that which was present in the prior petitions for certiorari in the Merry Brothers group of cases (Pet. 12-14).

The Government's attempt to show a difference in issue is based on the proposition that the statute "poses two problems: (1) What is included in the phrase 'ordinary treatment processes'? (2) How does one determine the identity of the 'commercially marketable mineral product'?" (Pet. p. 12) It then states that the first question was decided against the Government in the Merry Brothers group of cases and that the second question was not decided and is present here. We disagree. We believe it is inherent in construing this statute in the Merry Brothers group of cases that the "commercially marketable product" of the particular taxpayer involved was determined before any question regarding the treatment processes was decided. The statute requires, and the courts so found in the Merry Brothers cases that finished brick and tile, sewer pipe and related products were the "commercially marketable mineral products" of each particular taxpayer involved in such cases where the evidence showed that the taxpayer had no commercial market for its clay; just as

in the present case, the Court of Appeals held that taxpayer "did not have a commercially marketable product in its fire clay and shale", and that the finished sewer pipe was its first such product.

The factual distinction offered by the Government between the *Merry Brothers* cases and the present case is that the prior decision involved only operators who "extracted brick and tile clay (to be distinguished from fire clay) and made it into brick." (Pet. p. 13) *This is clearly a mis-statement of fact.* — The Merry Brothers petition involved a total of 13 cases which had been decided by the Court of Appeals for the 5th Circuit dealing with the depletion deduction for operators who mined brick and tile clay, *shale* and *fire clay*, and who processed such raw material into brick, tile, sewer pipe and other related burnt clay products. Two of the cases in the Merry Brothers petition involved fire clay [6] this being one of the minerals involved in the present case. In still another case involving fire clay, the Government stipulated that it should be affirmed by the Fifth Circuit if certiorari was denied in the *Merry Brothers* case.[7]

In each of the fire clay cases, the Government introduced

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[6] *Acme Brick Co.* v. *United States* 167 F. Supp. 911 (N.D. Tex. 1956), aff'd 57-1 U.S.T.C. 9617 (C.A. 5, 1957), cert. denied 355 U.S. 824; *Elgin-Butler Brick Co.* v. *United States*, 146 F. Supp. 378 (N.D. Tex. 1956), aff'd, 57-1 U.S.T.C. 9619 (C.A. 5, 1957), cert. denied 355 U.S. 824. This was fully recognized by the Government in the petition for certiorari in the *Merry Brothers* case where in Footnote 20, p. 21 of the petition it said: "For example, in two of the instant cases (*United States* v. *Acme Brick Co.*, and *United States* v. *Elgin-Butler Brick Co.*) involving fire clay, mined in Texas, the first commercial product was not reached until the mineral had been converted into burnt brick and tile."

[7] *Elgin-Standard Brick Mfg. Co.* v. *United States*, 153 F. Supp. 279, W.D. Tex. 1957), aff'd, 58-1 U.S.T.C. 9115 (C.A. 5, 1957).

evidence in an attempt to show that fire clay had a market in the form of raw clay. Each of the District Courts, however, found that while at some places in the United States there was a commercial market for raw fire clay, these markets were not available to the taxpayer involved because of heavy transportation costs, that there was no commercial market for the fire clay of the particular taxpayer except in the form of burnt clay products, and that somewhere between 75% and 90% of all of the output of fire clays in the entire United States are not commercially marketable until they are put in the state of finished, burnt clay products such as fire brick, tile, structural tile, sewer pipe and other products. The Courts further found that 90% of all of the miners of fire clay in the United States have to process the fire clay into finished products before there is any commercially marketable product.

The government's statement in the petition (Pet. p. 15) that "It cannot be ordinary or normal for miners of fire clay—*itself, a marketable product*—to apply those processes which are used by manufacturers of sewer pipe" (emphasis supplied) contradicts the findings in the *Acme Brick* and *Elgin-Butler* cases that in the entire United States it is the *normal* thing for miners of fire clay to process the clay into finished burnt clay products. The same findings were made by both of the lower courts in the present case that this taxpayer could not sell its fire clay and shale until it was processed into finished burnt clay products.

Another case in the Merry Brothers group involved only shale,[8] and figures from the Bureau of Mines identical to those introduced in the *Merry Brothers* case were intro-

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[8] *Texas Vitrified Pipe Co.* v. *United States*, No. 3329, (N.D. Tex. Feb. 1957) aff'd, C.A. 5 May 19, 1957, cert. denied 355 U.S. 824.

duced in evidence. Thus the prior petition for certiorari filed in the Merry Brothers case did include cases involving both of the minerals and the finished products now involved in the present case.[9] The Government stated to this Court in its petition for certiorari in the *Merry Brothers* case that "the facts and issues in the remaining cases are in all material respects the same as in the *Merry* and *Reliance* cases."[10]

The Government at the time of the Merry Brothers petition recognized the inevitability of the proposition that a decision for the taxpayer in that case required a similar decision in the case of fire clay and shale. Not only did it in effect so state to this Court,[11] but the proposition appeared to be so clear that the Government did not even wish to argue the *Acme* and *Elgin-Butler* cases in the Court of Appeals, but on the contrary stipulated that the cases should be affirmed without briefs or argument in the event the *Merry Brothers* decision was affirmed. Under such circumstances, it is surprising to find the government here

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[9] In the petition in this case, in a footnote to the decision of the Court of Appeals attached as Appendix A thereto, it is pointed out specifically that three of the cases covered by the Merry Brothers petition involved fire clay. (Pet., p. 31.)

[10] See Petition for Writ of Certiorari in *United States* v. *Merry Brothers Brick and Tile Co.*, et al, Oct. Term 1957, No. 220 at p. 7. The Government took advantage of Rule 23-5 of the revised rules of this Court by alleging in its petition that "all 13 cases involved substantially identical questions".

[11] Merry Brothers Petition (pp. 20-21): "Under the reasoning of the court below, the statutory basis for percentage depletion ('gross income from mining') will differ markedly as between taxpayers who mine one type of mineral rather than another, and *as between taxpayers who, although they are engaged in mining the same type of mineral, do their mining in different localities.*" (Emphasis supplied.)

urging as worthy of consideration by this Court an argument which has the same factual basis as was present in the prior cases presented to this Court but with the merit of which it was so little impressed as not to have presented to either the Court of Appeals for the 5th Circuit or to this Court in the Merry Brothers petition.

The Government also states that in the Merry Brothers petition the sole issue was whether manufacturing processes could be included within the term "mining" as used in the statute and that such question is not present here. However, in the present petition, the Government cannot make its argument without continually referring to "integrated miner-manufacturer", "finished manufactured products", and even says on page 6 of the petition: "What is at stake is ultimately this—May the deduction for depletion of mineral deposits, adopted on the theory that there should be an allowance for the exhaustion of a wasting asset, be converted into a prodigious tax benefit, available to selected taxpayers, for their *manufacturing activities?*" Thus the present petition recognizes that a decision cannot be made without again arguing the distinction between mining and manufacturing processes even though it recognizes that that issue was settled by *Merry Brothers* (Pet. p. 13).

The arguments raised in the present petition relating to discrimination, inequities,[12] and incongruities and as to the large impact upon the revenue[13] are in substance the

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[12] Of course, under the statute there will be some variation among producers of the same mineral, due to differences in local prices, products produced, net income, royalties paid, etc. Such variations are inherent in percentage depletion as this Court recognized in *Helvering* v. *Mountain Producers Corporation*, 303 U.S. 376, 381 (1938).

[13] Although two years have passed since denial of the petition for certiorari in Merry Brothers, it is shown in Table 1, Appendix C

same as those urged in the Merry Brothers petition and have since been urged in hearings before the Ways and Means Committee of the House of Representatives in an effort to have the marketable product test eliminated from the statute.

What the Government's argument really boils down to is: (1) the statute is too generous in that it results in a "prodigious tax benefit" and "the impact on the revenue is enormous" and (2) the *statute* is unfair in that it creates discrimination and results in unfair competition as between certain taxpayers. Assuming, arguendo, that these arguments are sound, they present a case for the Congress to investigate; but surely, they present no justiciable issue in regard to statutory construction which can only be resolved by the Supreme Court of the United States.

IV

The question raised in the petition is one for Congress—not for the Courts.

The courts, before and after the Merry Brothers decision, have been in agreement that the complaints of the Government against the construction of the statute now approved by this overwhelming body of unanimous judi-

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attached to the petition for certiorari in this case that there are still pending 82 cases involving brick and tile clay. It appears obvious from this that the Government has not given up on the Merry Brothers decision and would like to reargue it here. This is equally obvious from the fact that in attempting to show the so-called "potential tax loss resulting from the extension of percentage depletion to manufactured products," the Government in its Appendix C does not even attempt to segregate the alleged loss arising from the result in the Merry Brothers decision from the alleged loss resulting from the decision in this case.

cial decisions are complaints properly to be addressed to Congress and not to the courts.[14]

Immediately after the denial of certiorari in Merry Brothers, the Treasury went to Congress and asked for repudiation not only of the decisions as to brick and tile clay and cement rock, but also of the decisions as to fire clay.[15] This was in January, 1958. In January, 1959, the Treasury again went to Congress complaining of the results of these decisions and urging upon Congress the complete elimination from the statute of the "commercially marketable product" test which has prevailed for so long, even submitting a specific draft of a proposed amended Section 114(b)(4)(B) of the Code. Five days of hearings dealing with the subject were held by the Ways and Means Committee in March, 1959,[16] and another panel discussion before the Committee is set for December 1, 1959. The Treasury has placed before Congress all of its complaints

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[14] For example, Chief Judge Magruder stated: "The allowance for depletion has been a controversial subject for years, and officials of the executive branch have sought from time to time, with conspicuous lack of success, to persuade the Congress to eliminate some of its alleged overgenerous features. We are not concerned with the wisdom or policy of the statutory allowance, once we are sure what the allowance is, for it is plainly our judicial function merely to apply the allowance as Congress wrote it and meant it." *Dragon Cement Co. v. United States*, 244 F. 2d, 513, (C.A. 4, 1957).

[15] In the case of fire clay made into brick and tile, it requested not only a change of the cutoff point but also a reduction in rate from 15% to 5%.

[16] The arguments made by the Government in the present petition were presented to the Congress by Mr. David A. Lindsay, Assistant to the Secretary of the Treasury. Certain reactions by some of the Congressmen are illuminating in regard to the positions advanced in this petition and the same are attached to this brief as Appendix B.

about the present statute and has had a full opportunity to urge upon Congress the substitute provisions which it desires.

The wisdom of leaving the Government's complaints for Congress to review is readily apparent from the arguments advanced in its present petition. The arguments based on administrative convenience and equity among taxpayers illustrate the point.

In its petition the Government argues that the "rule adopted below is one which creates virtually insuperable administrative problems." But the position for which the Government contends here would instead impose upon the individual taxpayer (as well as the Commissioner) the "virtually insuperable" problem of determining a "market" price of raw minerals sold in different places in the country at different prices but for which the taxpayer had no market. If there is in fact any countervailing consideration of administrative convenience in the Government's position, the balancing of those considerations is clearly a matter for the Congress.

A similar problem of legislative policy is involved in the Government's argument that the decisions below favor the present taxpayer over nonintegrated miners of fire clay and shale. The Government fails to point out, however, that the adoption of its theory would work gross discrimination as between this taxpayer and integrated miners of *brick and tile clay*. The latter admittedly receive a depletion allowance based on the selling price of their finished burnt clay products since they cannot sell their clay in raw form, while the allowance for the taxpayer here—who likewise cannot sell its raw fire clay and shale—would be based on a hypothetical selling price of its *raw* minerals. Here again, any departure from the rules laid down in the prior cases would require a careful reexamination of the statutory policy which should be left to Congress. The fact that Congress (and the Treasury) have had the broad problems

of percentage depletion under extensive review simply underscores the wisdom of this course.

As the Government itself has said in successfully opposing a petition for certiorari in a case involving another complicated area of federal taxation:

> "The complicated problems involved are under continuing administrative and legislative study. This would seem to be a persuasive factor, in addition to those already stated, militating against further review at the present time of the question sought to be raised in this case." [17]

CONCLUSION

In conclusion, therefore, we respectfully submit that the present petition presents no important question which can only be resolved by a decision of this Court in view of the unanimity of decision in six Courts of Appeal and the Tax Court of the United States, and also in view of the fact that the factual situation on which the petition is based was present in the *Merry Brothers* cases in which this Court denied certiorari two years ago. Furthermore, if there ever was a case where the objections raised by the Government to a statute are peculiarly within the jurisdiction of Congress rather than the courts, this is such a case.

The petition for certiorari should be denied.

Respectfully submitted,

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NOVEMBER, 1959.

[17] Brief for Respondent in Opposition (pp. 13-14) in *Moe* v. *Earle*, October Term, 1955, No. 639, cert. den. 350 U.S. 1013.

APPENDIX A

The following is an excerpt from the opinion of the Tax Court of the United States filed on November 25, 1959 in the case of *Halquist* v. *Commissioner* 33 TC No. 36; (footnotes omitted):

"With the objective of providing a simplified method of computing depletion allowances which would avoid the complications and difficulties arising in connection with cost and discovery depletion, Congress in 1936 introduced percentage depletion based on 'gross income from the property.' The ambiguity inherent in the phrase 'gross income from the property' and the disputes arising therefrom led to the enactment in 1943 of the definition found in subsection (B) of section 114(b)(4), which has been carried substantially intact through the 1954 Code. Although it then became clear that the gross income upon which the depletion allowance was to be based was to include income derived from processes that went beyond mere extraction of the mineral from the ground, the basis for disputes had not been eliminated—it shifted in focus to the interpretation of the new phrase 'ordinary treatment processes normally applied by mine owners and operators in order to obtain the commercially marketable mineral product or products * * *.'

"It was soon settled that 'commercially marketable mineral product' meant the *first* commercially marketable mineral product resulting from the application of ordinary treatment processes. *International Talc Co.*, 15 T.C. 981; *Black Mountain Corporation*, 21 T.C. 746; *Riverton Lime & Stone Co.*, 28 T.C. 446.

"In an effort to limit the scope of 'mining' as defined in subsection (B), however, the Commissioner persistently attempted to distinguish and draw a line between extraction processes and manufacturing processes, arguing that the latter were not allowable 'ordinary treatment processes.' The courts rejected this

effort. In *United States* v. *Cherokee Brick & Tile Company*, 218 F. 2d 424 (C.A. 5); *United States* v. *Merry Brothers Brick and Tile Co.*, 242 F. 2d 708 (C.A. 5), certiorari denied 355 U.S. 824; and *United States* v. *Sapulpa Brick and Tile Corporation*, 239 F. 2d 694 (C.A. 10), contrary to the Commissioner's contention that the processes by which raw clay was transformed into burnt brick and tile were unallowable manufacturing processes, it was held that fully processed brick and tile were the first commercially marketable products from the mineral involved, and that all of the processes utilized to obtain this product were ordinary treatment processes. *Dragon Cement Company* v. *United States*, 244 F. 2d 513 (C.A. 1), certiorari denied 355 U.S. 823, held that manufactured cement, involving a chemical change in the processing of the raw mineral, was the first commercially marketable product from cement rock. *Riverton Lime & Stone Co.*, *supra*, held that hydrated hydraulic lime was the first such product from a limestone mine. In *Townsend* v. *Hitchcock Corporation*, 232 F. 2d 444 (C.A. 4), pulverized talc and talc crayon were found to be the commercially marketable products obtained from ordinary treatment processes, regardless of whether they may be considered to be 'manufactured' products. These and other courts were of the uniform opinion that the statutory language was clear and unambiguous, and that gross income from mining included the income from all processes ordinarily and normally applied to obtain the first product marketable in commerce. The depletion allowance not being an allowance upon any processes as such, did not necessitate distinguishing between mining processes and manufacturing processes.

"Shifting his emphasis now to a new theory which would restrict the scope of the depletion allowance, respondent here argues that the first commercially marketable mineral product in any particular mining industry is the crudest, least-processed product for which a commercial market exists in the United States in more than negligible quantities, and that the proc-

esses utilized and normally applied by mine owners and operators in that industry to produce this crudest marketable product are the only processes which can be considered to be ordinary treatment processes within the meaning of the statute. To ascertain the crudest, least-processed, yet marketable, product for the particular mineral industry involved, respondent would look to the country as a whole. Once the product base had been determined for an entire industry it would serve as the standard for all of the producers of that mineral, notwithstanding that an individual miner or operator may not produce or market it or be capable of marketing it at a profit. Those who processed and marketed a product other than the standard industry product would be required to utilize as their depletion base a gross income reconstructed by reference to the representative market price of the crudest, least-processed marketable product from a mineral of like kind and grade, or if there is no such market price, respondent would allocate and eliminate on the basis of costs all income attributable to processes beyond those necessary to produce the crudest product.

"For the dolomite and limestone industry, then, respondent shows that the crudest, least-processed product marketed in more than negligible quantities is crushed and broken stone. The processes normally applied by limestone and dolomite operators to obtain crushed and broken stone, respondent contends, are the only 'ordinary treatment processes' contemplated by the state. This would be so in spite of the variety of products which may be and are in fact produced from a limestone or dolomite mine. Thus in petitioner's case the gross income from the sales of their crushed stone would all be includible in the depletion base. On the other hand, respondent insists, income from the sale of building or dimension stone, a more highly-refined product utilizing processes quite different from those required to produce crushed stone, would be excluded to the extent of the income attributable to the additional processing steps—that is, in-

come from the sale of building stone must be limited to the income that would have been derived if such stone had been sold as crushed and broken stone.

"The so-called 'least-processing' theory appears to have first been advanced by respondent before the Seventh and Eighth Circuits in his appeals from the district court's decision in *Canfelton Sewer Pipe Co.* v *United States*, 268 F. 2d 334 (C.A. 7), and from this Court's decision in *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398 (C.A. 8), affirming 28 T.C. 881, both of which were still pending when the case here before this Court was submitted. Since then both appellate tribunals have handed down their decisions and both totally rejected respondent's interpretation.

"In *Canfelton*, the taxpayer mined fire clay and shale and manufactured therefrom vitrified clay sewer pipe and related products. The income derived from the sale of his fully processed products was used as his basis for depletion. The Government urged that since there was an existing substantial market for raw clay and shale in the immediate area, as well as in the State of taxpayer's mine, the raw unprocessed mineral was his first commercially marketable product. The Court pointed out that taxpayer's mining costs alone, due to a more expensive underground type of operation, exceeded the current selling price of raw clay and shale, and in view of this fact was unable to understand how raw clay and shale could be considered commercially marketable products for this particular taxpayer. In the Court's view, taxpayer had to be in a position to sell his product at a profit before it was 'commercially marketable,' and in order to achieve this end, taxpayer found it necessary to further process his raw material into vitrified clay sewer pipe. The evidence also showed that integrated mining and manufacturing operations wherein the raw material was processed by the mining operators into a finished product was the rule rather than the exception in taxpayer's area in the year involved, and that the treatment processes used to obtain his finished prod-

ucts were ordinary and normal. In rejecting respondent's contention that there can be only one depletable or commercially marketable product for each mineral, the Court said:

> The short answer to this is that we do not agree that it was intended that the depletion allowance for each mineral be reduced to the common denominator represented by a conceivable product most cheaply produced from each mineral.

"Again respondent urged in *Iowa Limestone* that the crudest, least-processed product marketable from taxpayer's limestone quarry was crushed limestone, even though taxpayer marketed only finely ground or pulverized chemical grade limestone. Although there clearly was a market for crushed limestone for road and agricultural purposes and taxpayer's stone could have all been crushed and utilized for such purpose (as a minor amount of dirty and contaminated material was), his "deposit of limestone was a relatively rare and special type particularly suitable for chemical use. In its pulverized form processed for chemical use, the limestone was considerably more valuable and commanded a higher price than crushed stone. The Court was of the opinion that the taxpayer

> had the right to market its chemical grade limestone for the purpose for which it was most suited and in a field where it would command a fair price. Gold, silver, and iron ores and other valuable minerals could doubtless be sold for road rock, fill, or ballast, but no one would contend that their value must be determined upon such a limited use of such products. It was not economically feasible for the taxpayer to market its superior stone as ordinary road rock. Many kinds of cheap stone would equally serve such a purpose.

"While there are some differences in the facts in those two cases and in this case, the courts in those cases specifically rejected substantially every argu-

ment advanced by respondent in this case in support of his most recent theory, and we think the principles announced in those decisions are equally applicable here.

"In both of those cases the courts rejected the argument that the one most cheaply-produced product of the mineral that could be produced and sold at a profit by someone somewhere in the country was the commercially marketable product for all taxpayers in that industry, regardless of whether it was economically feasible for the particular taxpayer to produce and market that product at a profit. Both courts stated that the profit-making aspect must be given consideration in determining whether a mineral product is commercially marketable, and that the taxpayer has a right under the statute to market its mineral for the purpose for which it is most suited. We agree. *Riverton Lime & Stone Co., supra; Iowa Limestone Co.*, 28 T.C. 881."

APPENDIX B

In March, 1959, the Ways and Means Committee of the House of Representatives held extensive hearings on the very section of the Revenue Code of 1954 which is identical with the section now under consideration from the Revenue Code of 1939 at which time the Treasury presented all of its arguments in favor of removing the commercially marketable product test entirely and substituting therefor a cutoff point in the processing of minerals which supposedly stops the allowable processing at the conclusion of mining as distinguished from manufacturing. The hearings were printed as a report entitled "Mineral Treatment Processes for Percentage Depletion Purposes". The following excerpts relate directly to certain arguments advanced by the Government in the present petition which were also made by the Department of Treasury through David A. Lindsay, Assistant to the Secretary of the Treasury.

1. As to the argument concerning "loss of revenue" by reason of the interpretation which the courts have put upon the statute, Congressman Noah M. Mason had this to say: "The Treasury says it is a loss to the Treasury, $300 million or $100 million, or whatever it is. How can it be a loss to the Treasury if, when the actual law is applied, it gives this depletion allowance to the industry? How can the Treasury claim that is a loss if it belongs to the industries? Also, the Treasury refused to return or rebate the money they have collected, not according to law, but according to their rulings, and so now the industries have to sue to get their money back, money that belongs to them. That is the picture as it presents itself to me, and your testimony does not change that picture as I see it." (Report, p. 14)

2. As to the argument that the interpretation put upon the statute is in conflict with the theory of percentage depletion and that a depletion deduction is solely for the purpose of allowing a recovery of a capital investment, Congressman Howard H. Baker in examining Mr. Lindsay had the following exchange: "*Mr. Baker.* Now percentage depletion is statutory language. *Mr. Lindsay.* That is cor-

rect. *Mr. Baker.* I always understood that one of the basic reasons for percentage depletion was to encourage the mineral industries to plow money back into discoveries to find new fields so that natural resources would not be depleted when they are so needed in the national interest. That has been my understanding of the basic reasoning behind percentage depletion. Am I wrong on that concept? *Mr. Lindsay.* No; I think you are correct, Mr. Baker. *Mr. Baker.* That is really the basic reason? *Mr. Lindsay.* Yes." (Report, p. 27)

3. As to the argument that the present interpretation leads to uncertainty and terrific administrative problems, Congressman Richard M. Simpson made the following statement to Mr. Lindsay: "Certainly we have comparative stability. The Department has been told now by the courts just where depletion is to apply, the amount of money, based upon decisions at hand, is not too large, in my judgment. Certainly it is a small price to pay for stability in a field where cases have been hanging open for years, 6, 7, or 8 years, because we have not been able to reach an administrative decision. I think we might advisedly retain something that gives us an element of certainty rather than adopt the terrific uncertainty that we would find from the approval of a new approach to this question." (Report, p. 23).

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JAMES R. BROWNING, Clerk

No. 513

In the Supreme Court of the United States

OCTOBER TERM, 1959

UNITED STATES OF AMERICA, PETITIONER

v.

CANNELTON SEWER PIPE COMPANY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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HOWARD A. HEFFRON,
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REPLY BRIEF FOR THE UNITED STATES

Respondent's brief in opposition does not deny that the issue raised by the Government's petition is one of great importance both in its tax and in its other economic aspects. Its brief is also conspicuously lacking in any effort to defend the merits of the decision below. Thus, nowhere does respondent meet the Government's contention that the instant decision, taken in conjunction with the decision in the *Merry Brothers* group of cases,[1] has denied effective meaning to the statutory limitation inherent in the words "*ordinary* treatment processes *normally* applied by mine owners or operators in order to obtain the com-

[1] *United States* v. *Merry Brothers Brick & Tile Co.*, 242 F. 2d 708, certiorari denied, 355 U.S. 824.

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mercially marketable mineral product * * *" (emphasis added). These words require, we submit, one of two conclusions: (1) that Congress proposed to limit the depletion base to certain types of processes functionally related to mining;[2] or (2) that Congress proposed to limit the depletion base by restricting the taxpayer to the most basic marketable product obtainable in the particular branch of the mining industry involved.[3] Putting aside the inequities and the economic incongruities to which respondent's view leads, we pose the question: How, as a matter of statutory interpretation, can the quoted language be read as meaning that one miner of iron ore may obtain depletion on the basis of the market value of iron ore and another on the basis of the market value of pig iron or structural steel; that one miner of salt may obtain depletion on the basis of the sales price of raw salt in bulk and another on the basis of the sales price of salt packaged for the housewife in small containers; that one miner of fire clay may obtain depletion on the basis of the market price of fire clay (widely sold in raw form) and other such miners on the basis of the sales prices of bathroom tile, sewer pipe and costly ceramics?

To this, respondent's essential reply is that this Court should not concern itself with the case because the matter is already settled by six Courts of Appeals (a threefold exaggeration), because the Court did not previously pass upon the statutory provision involved

[2] The position advanced by the Government in its petition in *Merry Brothers*.

[3] The narrower alternative urged in the instant petition.

when the Government sought certiorari in *Merry Brothers*, and because Congress could correct the situation for future years by amending the tax laws.

The legal theory advanced in the Government's present petition was argued and decided for the first time in the instant case.[4] The court below recognized this. It declared, quite correctly, that in prior cases arising under the same statutory provision "the Government's basic contention was that manufacturing processes could not be 'ordinary treatment processes' within the meaning of the Code" (Pet. App. 25);[5]

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[4] The same contention was subsequently made in *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398 (C.A. 8th). See Pet., p. 14, note 20.

[5] The first Court of Appeals decision in this area was the Fifth Circuit's decision in *United States* v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424, in which the court, dealing with the contention that manufacturing processes are to be excluded, stated (p. 425): "There is no provision in the statute for excluding any process before such a marketable product is reached. The only restriction is that the processes must be the ordinary treatment processes normally applied by mine owners or operators."

In the *Merry Brothers* case, *supra*, the Fifth Circuit was asked to reconsider the precise issue decided in *Cherokee*. It did so and reaffirmed its *Cherokee* holding. 242 F. 2d at 710. The sole issue presented to this Court in the petition filed in *Merry Brothers* was "whether the mine owner's manufacturing operations are to be considered 'ordinary treatment processes * * *'" (Pet., No. 220, Oct. Term, 1957, p. 3).

Recently, in *Alabama By-Products Corp.* v. *Patterson*, 258 F. 2d 892, certiorari denied, 358 U.S. 930, the Fifth Circuit observed (pp. 899–900, note): "The Cherokee Brick & Tile case is not applicable. The question of whether there was a representative market price for clay at the state of processing prior to the manufacturing of the finished brick was not involved; *the issues were limited to whether the processes applied were ordinary treatment processes, and whether the finished product was a mineral product*" (emphasis added).

that the Government has not "renewed" this argument in the instant case (*ibid.*); and that the question now posed for decision is whether the concept of "commercially marketable product" established an industry-wide criterion or an individual one (Pet. App. 27–29).

Respondent claims, however, that *Merry Brothers*, in which the Court denied certiorari, actually involved the same issue as is presented here (albeit the briefs, the Court of Appeals' decision and the Government's petition were addressed solely to the question whether the term "ordinary treatment processes" includes manufacturing processes). It points out that when *Merry Brothers* was decided in the Fifth Circuit, that court concurrently disposed of twelve companion cases. Two of those cases, respondent states (Br. 8–9), involved the mining of fire clay and in both of those cases the miners had claimed depletion on the basis of finished products made from fire clay. This indicates, to be sure, that the Government might have raised in those cases, as an alternative ground for reversal, the issue which it later raised in the instant case. It does not indicate that the Government did raise the issue (in fact, it did not) or that the issue was considered or decided in the Court of Appeals (in fact, as the Court of Appeals' opinion in *Merry Brothers* makes clear, it was not).

The Government's position in this area of litigation has been neither devious nor complex. In the litigation which preceded the instant case, the Commissioner rested upon the broad contention that the statute should be interpreted to restrict the depletion

base to *mining* processes as distinguished from manufacturing processes. If that contention had been accepted by the courts, the instant problem would be relatively inconsequential. When the Government failed, in the first series of cases, to persuade the lower federal courts of the correctness of that broad contention, and when it found itself confronted with rapidly expanding claims by taxpayers that they were entitled to include manufacturing processes utilized to produce highly processed, expensive finished products, it answered as follows: Granting that taxpayers have been held entitled to include in the depletion base all processes, whether mining or manufacturing, necessary to obtain the commercially marketable product, taxpayers are nonetheless restricted to the basic marketable product made in the relevant branch of the mining industry. Respondent seems to be saying that the Government, having lost on its broad theory in one group of cases, is barred from urging a different and narrower theory in subsequent cases if it might have found a way to present both theories alternatively in the first instance. This is indeed novel doctrine. If, as is argued in the petition for certiorari, the decision below wholly distorts the statutory provisions dealing with tax depletion for mining and would result in losses to the revenue of more than a half-billion dollars annually, the need for review by this Court is in nowise obviated by the circumstance that the question here presented was not presented earlier.

Respondent also suggests that, however unsound the result reached below and however important the

issue, there is no real need for review because Congress can change the relevant tax provision. This overlooks, to begin with, the hundreds of cases, both pending and potential, involving past years and the current tax year.[6] More important, it ignores the consideration that the legal issue presented is one of statutory interpretation—a judicial issue. Respondent's approach seems to be based on the premise that the more important an issue of statutory interpretation, the less occasion there is for an exercise of certiorari jurisdiction because the more appropriate it is that Congress, not this Court, should resolve the issue. This is to state in reverse the governing criteria. Carried to its logical conclusion, this would mean that this Court should review only the less important questions of statutory construction and decline judicial issues which are of pressing national concern.

[6] The amount of revenue involved for this period may aggregate close to a billion dollars. See Appendix to the Petition, Tables 1 and 2, pp. 39–40.

CONCLUSION

For the reasons set forth in the petition and the additional reasons noted above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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JAMES R. BROWNING, Clerk

No. 513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

UNITED STATES OF AMERICA, *Petitioner,*

v.

CANNELTON SEWER PIPE COMPANY, *Respondent.*

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF AMICUS CURIAE OF THE NATIONAL COAL ASSOCIATION

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IN THE

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OCTOBER TERM, 1959

No. 513

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MOTION OF THE NATIONAL COAL ASSOCIATION FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE

Pursuant to Rule 42 of the Rules of the Supreme Court of the United States, the National Coal Association respectfully moves for leave to file the accompanying brief on the merits as *amicus curiae* in this case.[1] The consents of the petitioner and of the respondent have been requested, but have not been granted.

The National Coal Association is a trade association whose members mine and market more than two-thirds

[1] Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit in this case was granted December 14, 1959.

of the commercially produced bituminous coal in the United States.

This case involves the question of whether the Cannelton Sewer Pipe Company's deductions for depletion, under the Internal Revenue Code of 1939, are to be computed on the basis of fire clay and shale (mined by the Cannelton Sewer Pipe Company) or sewer pipe and other finished products (manufactured by the Cannelton Sewer Pipe Company from fire clay and shale mined by it). The case involves the interpretation of sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939.

The members of the National Coal Association compute their deductions for depletion under the same sections and subsections of the Internal Revenue Code of 1939 as are applicable to fire clay and shale, namely, sections 23(m) and 114(b)(4).

The statute specifically provides that "ordinary treatment processes" for depletion purposes in the case of coal shall include the following:

> ". . . cleaning, breaking, sizing, and loading for shipment. . . ."

The National Coal Association has no doubt that all of these processes are allowable as a part of "mining" in the case of coal, for depletion purposes, whether or not a market for the coal exists without applying such processes.

The movant wants to be certain that this Court does not inadvertently cast any doubt upon the foregoing stated position. It has some justification for fearing that such doubt may be cast by the opinion of this Court because of the unnecessarily broad and sweeping statements of the United States in its petition for certiorari and reply brief to the effect that "the gross income from mining."

Internal Revenue Code of 1939, section 114(b)(4)(B)(i).

for depletion purposes, ends at the point where the most basic product is arrived at.

The movant is not a participant in the controversy between the United States and the Cannelton Sewer Pipe Company as to the correct computation of depletion allowances for fire clay and shale. Although the same sections and subsections of the Internal Revenue Code of 1939 are involved in computing depletion allowances both for fire clay and shale and for coal, specific statutory provisions apply to coal which are not applicable to fire clay and shale.

If this Court should decide to uphold the contention of the United States that "Congress, at the least, meant to confine the allowance [for depletion] to the basic product sold by the particular mining industry," then it is of vital importance to the movant that this Court avoid casting any doubt on the allowability as "mining" of at least all of those processes applicable to coal which are specifically listed by Congress in section 114(b)(4) of the Internal Revenue Code of 1939.

Respectfully submitted

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Petition for Writ of Certiorari in *United States* v. *Cannelton Sewer Pipe Company*, October Term 1959, No. 513, p. 15.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 513

UNITED STATES OF AMERICA, *Petitioner*,

v.

CANNELTON SEWER PIPE COMPANY, *Respondent*.

BRIEF AMICUS CURIAE OF THE NATIONAL COAL ASSOCIATION

INTEREST OF AMICUS CURIAE

The interest of the *amicus curiae* in this case is set forth in the motion to which this brief is attached.

ARGUMENT

I. The Amount of "The Gross Income From the Property" in the Case of Coal Has Been Specified by Congress Since 1943 (Effective Retroactively to 1932).

The broad authorization for deducting an allowance for depletion is contained in section 23(m) of the Internal Revenue Code of 1939, which provides in pertinent part as follows:

> "In computing net income there shall be allowed as deductions . . . . In the case of mines . . . a reasonable

allowance for depletion . . ., according to the peculiar conditions in each case."

Substantially the same provision is to be found in section 611(a) of the Internal Revenue Code of 1954. Some provision for depletion of mines has been contained in every revenue law since the Revenue Act of 1913.

The statutory provision for an allowance for depletion in the case of coal is (Internal Revenue Code of 1939, section 114(b)(4)(A)):

> "The allowance for depletion under section 23(m) in the case of the following mines . . . shall be
>
> . . . . . "
>
> "(ii) in the case of coal, . . . 10 per centum,
>
> . . . . . .
>
> of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property . . . ."

This provision was reenacted in substance as section 613(a) and (b) of the Internal Revenue Code of 1954. Similar provisions as to coal have have been contained in all revenue laws since the Revenue Act of 1932, except that in 1951 the allowable percentage of gross income was raised from 5 to 10. The "50%-of-net-income" limitation has remained constant.

For purposes for computing percentage depletion, the term "gross income from the property" means "the gross income from mining" (Internal Revenue Code of 1939, section 114(b)(4)(B); reenacted in Internal Revenue Code of 1954, as section 613(c)(1)).[4] The term "mining"

[4] "As used in this paragraph [i.e., paragraph (4) of section 114(b)] the term 'gross income from the property' means the gross income from mining. The term 'mining,' as used herein,

includes three categories of operations (Internal Revenue Code of 1939, section 114(b)(4)(B); reenacted in Internal Revenue Code of 1954, as section 613(c)(2)):

(1) "The extraction of the ores or minerals from the ground";

(2) "The ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products"; and

(3) In general, "so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles."

The term "ordinary treatment processes," which is an integral part of the definition of the term "mining," is defined to include certain specifically stated processes for certain specific minerals and for broad categories of minerals, and also some generally stated processes for specific minerals and for broad categories of minerals. Some processes are expressly excluded.

The term "the commercially marketable mineral product or products" is not defined in the statute. Neither is the descriptive phrase "normally applied by mine owners or

---

"shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. . . . The term 'ordinary treatment processes,' as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; . . ." This provision was added, as section 114(b)(4)(B) of the Internal Revenue Code of 1939, by section 124(c) of the Revenue Act of 1943, and made retroactively effective to 1932 (58 Stat. 45). With an amendment in 1954 (which will be discussed in detail hereafter), it has remained in the Internal Revenue Code continuously since 1943, and now is contained in section 613(c)(1), (2), and (4)(A) of the Internal Revenue Code of 1954.

operators" defined in the Code. Thus, there is lacking in the statute any all-inclusive definition of the important words "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products."

The basic contention of *amicus curiae* is that, regardless of what this Court may determine to be the meaning of the last-quoted phrase (or any of its parts) with respect to fire clay and shale, this phrase cannot in any event operate as a limitation on the "ordinary treatment processes" listed for coal in the very next sentence of section 114(b)(4)(B). This sentence provides in pertinent part:

> "The term 'ordinary treatment processes,' as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment."

II. The Processes Listed by Congress in Section 114(b)(4)(B)(i) of the Internal Revenue Code of 1939 Are All Clearly Allowable in Determining "The Gross Income From Mining" in the Case of Coal, Without Regard to Whether Any or All of Such Processes Are, in Fact, Necessary "in Order to Obtain the Commercially Marketable Mineral Product or Products."

The United States, in its petition for certiorari in this case, has (perhaps unintentionally) used extremely broad language which, if accepted by this Court, would tend to cast doubt on the above interpretation of the statute as it relates to coal.

Such interpretation is, we submit, unquestionably correct. Apparently denying that the problem of what is included in the phrase "ordinary treatment processes" is involved in the present case, and urging that the only problem involved is how to determine the identity of the "commercially marketable mineral product," the United States contends that the latter term refers to the basic

product sold by the particular mining industry—that is, the first (cheapest and most primitive) commercially marketable product made by the branch of the mining industry concerned.[5]

Whatever the merits of this argument as applied to fire clay and shale (and we express no opinion as to this question), it is clearly erroneous as applied to coal and to other mineral products as to which Congress has seen fit to list certain processes which are allowable as "ordinary treatment processes" in determining "the gross income from mining."

The plain language of the statute compels this conclusion. Congress has used the words "shall include," rather than "may include" or some other similarly permissive language, to introduce its listing of processes which are, in the case of coal, "ordinary treatment processes." At least all of the listed processes are to be considered "mining" in the case of coal. It is thus entirely clear that "cleaning, breaking, sizing, and loading for shipment" are to be considered a part of "mining," for depletion purposes, in all instances where a taxpayer owning a mineral "property" applies such processes (or any of them) to coal extracted therefrom.[6]

The plain meaning of the language used in the statute is reinforced by the legislative history of the provision

[5] Petition for Writ of Certiorari in *United States* v. *Cannelton Sewer Pipe Company*, October Term 1959, No. 513, pp. 11-5; Reply Brief for the United States, ibid., p. 2.

[6] In addition, the owner of a coal "property" may, in some instances, be entitled to percentage depletion (computed as indicated in the preceding sentence) even if the specified "ordinary treatment processes" and other parts of the "mining" operation are not performed by him, due to the provision in section 23(m) of the Internal Revenue Code of 1939 that "In the case of leases the deductions shall be equitably apportioned between the lessor and lessee."

defining "the gross income from mining" in the case of coal. The definition of "mining" was added to section 114(b)(4) of the Internal Revenue Code of 1939 by section 124(c) of the Revenue Act of 1943 (58 Stat. 45). This provision was added by the Senate Committee on Finance, not having been included in the House bill. The following explanations in both the "Summary of Principal Changes" and the "Detailed Discussion of the Technical Provisions of the Bill" in this Committee's report spell out the intention of Congress with complete clarity (S. Report No. 627, pp. 23-4, 55 (1943); 1944 I.R.B. pp. 991-2, 1013; italics added):

> "Section 114(b)(4) of the Code is amended to include a definition of 'gross income from the property' for purposes of percentage depletion of mines. . . . The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines.
>
> "The law has never contained such a definition, and its absence has given rise to numerous disputes. *The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions.*
>
> * * * * * *
>
> "Subsection (c), which was not in the House bill, adds a new subparagraph (B) to section 114(b)(4) of the Code to define for the purposes of section 114(b)(4) the term 'gross income from the property.' For such purposes the term 'gross income from the property' means the gross income from mining. The term 'mining' shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to

obtain the commercially marketable mineral product or products. It is further provided that *the term 'ordinary treatment processes,' as so used, shall include the following:*

"(1) *In the case of coal—cleaning, breaking, sizing, and loading for shipment; . . .*"

Further indications of the intention of Congress are to be found in other actions taken with respect to the depletion allowance for coal for the taxable year 1951 (the year involved in this case, and the year in which fire clay and shale, the minerals involved in this case, were added to the list of minerals entitled to percentage depletion).

In the first place, the percentage depletion rate for coal was increased from 5% to 10% of "the gross income from mining," by section 319 of the Revenue Act of 1951 (this was the same section which added fire clay and shale to the list of minerals entitled to percentage depletion). The increase in the depletion rate for coal was made applicable to all taxable years beginning after December 31, 1950.[7]

In the second place, Congress provided that the income from coal royalties should be considered as gain or loss upon the sale of coal (subject to capital gains treatment), and at the same time specified that an owner of coal qualifying for such capital gains treatment "shall not be entitled to the allowance for percentage depletion provided for in section 114(b)(4) with respect to such coal." This provision, section 117(k)(2) of the Internal Revenue Code of 1939, was made applicable to taxable years ending after December 31, 1950, but only with respect to amounts received or accrued after such date.[8]

[7] P.L. 594, 82d Cong., 2d Sess., section 5, amended section 319(e) of the Revenue Act of 1951 to provide that the amendments made by section 319 should be effective on and after January 1, 1951 (66 Stat. 820).

[8] Added by Revenue Act of 1951, section 325 (65 Stat. 501).

The enactment of these two provisions in the Revenue Act of 1951 shows that Congress carefully considered the matter of depletion allowances for coal, and determined to make one liberalizing amendment and one restrictive amendment with respect thereto. No action whatsoever was taken with respect to the definition of "mining," which had been in the Internal Revenue Code since 1943, and none was even remotely considered.[9]

III. The Conclusion That Considerations of Marketability Are Irrelevant in Determining "The Gross Income From Mining" in the Case of Coal Is Reinforced by Subsequent Legislation on the Same Subject.

In 1954 Congress amended the Internal Revenue Code's definition of "mining" by adding to the list of "ordinary treatment processes" in the case of coal the following: "dust allaying, treating to prevent freezing." The amended provision reads (Internal Revenue Code of 1954, section 613(c); new language indicated by italics):

> "(c) DEFINITION OF GROSS INCOME FROM PROPERTY.—For purposes of this section—
>
> "(1) GROSS INCOME FROM THE PROPERTY.—The term 'gross income from the property' means, *in the case of a property other than an oil or gas well*, the gross income from mining.
>
> "(2) MINING.—The term 'mining' includes not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, . . .
>
> • • • • • •
>
> "(4) ORDINARY TREATMENT PROCESSES.—The term 'ordinary treatment processes' includes the following:

[9] See H. Report No. 586, pp. 29-32, 114, 117-8 (1951); S. Report No. 781, pp. 37-8, 42-3; *id.*, Part 2, pp. 37, 43-5 (1951).

"(A) In the case of coal—cleaning, breaking, sizing, *dust allaying, treating to prevent freezing*, and loading for shipment; . . ."

Both the fact of the addition of "dust allaying, treating to prevent freezing" to the "ordinary treatment processes" for coal, and the legislative history leading up to such addition, show beyond peradventure that Congress has always intended (since the original enactment of the provision in 1943) that all of the listed processes shall be considered as "mining" without any regard to marketability. The amendment contained in the Internal Revenue Code of 1954 presents an instance where subsequently enacted legislation may be "considered to throw a cross light" on what has gone before (to borrow the words of Judge Learned Hand in *United States* v. *Aluminum Company of America*, 148 F. 2d 416, 429 (C.A. 2 (1945)).

On February 25, 1954 (prior to the amendment), the Tax Court had ruled that dust allaying of coal was not an "ordinary treatment process" and hence not a part of "mining" for depletion purposes (*The Black Mountain Corporation* v. *Commissioner of Internal Revenue*, 21 T.C. 746). The reason for the court's conclusion was that "the first commercially marketable mineral product was the coal itself," or, in other words, that dust allaying was not "necessary to create a commercially marketable mineral product out of the coal in question."[10] The court found that over 90% of all coal sold was sold without dust allaying. This fact was specifically pointed out to the Senate Committee on Finance when it was considering the 1954 amendment.[11]

[10] 21 T.C. at 757. Although reaching a result adverse to the taxpayer with respect to dust allaying, the Tax Court clearly indicated its belief that Congress, by its use of the word "include" (in section 114(b)(4)(B) of the Internal Revenue Code of 1939), "intended to encompass also other processes used to produce commercially marketable coal" (21 T.C. at 756, and f.n. 3).

[11] Hearings before the Committee on Finance, United States Senate, on H.R. 8300, Part 3, pp. 1409-18 (1954).

Thus, the exact purpose of Congress in listing "dust allaying" (in section 613(c)(4)(A), Internal Revenue Code of 1954) as being included within the term "ordinary treatment processes" was to reverse the effect of the Tax Court's decision in the *Black Mountain* case. A construction of the statute which made the allowability of dust allaying as a part of coal "mining" dependent upon the lack of a market for coal without such treatment process would be completely unsupportable, since it would amount to a finding that Congres accomplished nothing by adding dust allaying to the list of "ordinary treatment processes." No sensible reading of the provisions in the Internal Revenue Code of 1939 prior to this amendment could, we submit, make the allowance of any of the processes then listed by Congress dependent in any way upon the lack of a market for coal without the application of such process or processes.

IV. Subsequent Official Statements by the Treasury Department Further Emphasize the Correctness of the Proposition That, in the Case of Coal, "Mining" Shall Include All of the Processes Listed in Section 114(b)(4)(B)(i) of the Internal Revenue Code of 1939, Without Regard to Marketability.

The Treasury Department itself has long allowed all of the listed processes in the case of coal to be considered as "mining" for depletion purposes, regardless of whether the coal was marketable without the application of such processes. In fact, Treasury Regulations had expressly provided for the allowance of the listed processes since 1932 (long before their codification in 1943), as was recognized by Treasury officials testifying before the House Committee on Ways and Means in March, 1959.[12] This testimony, presented in connection with a Treasury draft bill to amend the definition of "the gross income from

[12] Regulations 77, Relating to the Income Tax, under the Revenue Act of 1932, Article 221(g)(1), p. 61 (1933).

mining", clearly shows that the Department as that recent date recognized all the listed processes as "mining" in the case of coal, without regard to any theory of marketability, and was not then asking Congress to make any change in this respect.

The following excerpt from the material submitted to the House Committee on Ways and Means by the Treasury Department at the request of Congressman Ikard clearly spells out the long-standing administrative interpretation of "mining," for depletion purposes, in the case of coal (Hearings before the Committee on Ways and Means, House of Representatives, "Mineral Treatment Processes for Percentage Depletion Purposes," pp. 30-2 (1959); italics added):

"LEGISLATIVE HISTORY AS TO CUTOFF POINT

* * * * * * *

"Treasury regulations were promulgated to define gross income from the property as used with respect to *coal*, metal mines, and sulfur. Regulations 77 promulgated under the Revenue Act of 1932 article 221(g), closely parallels the present day statutory provisions and regulations. These regulations said plainly that 'gross income from the property' meant the selling price of the crude mineral product or, if the crude product were not sold as such but was processed, the field price before the application of any processes to which the crude mineral product may have been subjected (*with the exception of certain specified processes discussed below*) and before transportation from the place where the last of the specified processes was supplied. *The processes enumerated, which were allowed to be applied to increase the value of the capital which was allowed tax-free recoupment, were clearly of the type which were regarded as processes which resulted in a product of a mine* (i.e., mineral concentrates) as distinguished from a manufactured or refined product. *Thus, coal could be cleaned, broken, sized and loaded at the mine for shipment;* sulfur could be pumped, cooled, broken and loaded at the mine

for shipment; and ores customarily sold in the form of a crude mineral product could be sorted, concentrated and loaded at the mine for shipment. Processes which resulted in a refined product, as compared to those which still left the mineral in a crude state, were not allowed in arriving at a value of the capital which was to be allowed tax-free recoupment.

"In the Revenue Act of 1943, Congress incorporated for the first time into the Internal Revenue Code *the ordinary treatment processes which were to be included in the concept of mining and the income from which would be within the definition of gross income from the property* (sec. 124(c), Rev. Act of 1943). In explaining this amendment, which originated as a Senate amendment, the Senate Finance Committee stated (S. Rept. No. 627, 78th Cong., 1st sess., pp. 23-24; 1944 cum. bull. 973, 992):

> "'The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines.
>
> "'The law has never contained such a definition, and its absence has given rise to numerous disputes. The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and *is in accord with the original regulations and the Bureau practices and procedures thereunder*. It is, therefore, made retroactive to the date of such original provisions.' [Emphasis supplied.]"

Testimony of Treasury Department officials in the March, 1959, hearings was to the effect that the Department's draft bill represented existing official administrative interpretations of the law relating to "the gross income from mining" for purposes of computing percentage depletion. Under the proposed bill, it was clear that all of the processes listed for coal in the existing statute would continue to be allowed without regard to any "marketability"

test. David A. Lindsay, Assistant to the Secretary of the Treasury, stated (*id.*, p. 3):

> ". . . the Treasury Department has long interpreted the statute to mean that the gross income to be used in the computation of the depletion deduction is the gross income attributable to treatment processes equivalent to those specifically named in the statute."

Similarly, Jay W. Glasmann, Assistant General Counsel, said (*id.*, p. 7; italics added):

> "The draft bill on mining is intended to restore the rules for computing gross income from mining which were applied prior to the recent court decisions. *No attempt has been made to roll back those processes which are treated as mining under express provisions of the statute or by administrative practice.*
>
> * * * * * *
>
> "*Certain processes in the case of coal*, sulfur recovered by the Frasch process, quicksilver ores, talc, magnesite, and phosphate rock *which are treated as mining in the present statute* are also treated as mining in the draft bill."

The following colloquy between Congressman Harrison and Mr. Lindsay shows beyond any reasonable doubt that the Treasury Department was not seeking, in March, 1959, to amend the statute in any way which would affect the existing, recognized, and long-standing methods of computing depletion allowances for coal (*id.*, p. 23):

> "MR. HARRISON. Mr. Lindsay, is the Treasury draft intended to affect the present methods of computing depletion allowances on coal?
>
> "MR. LINDSAY. No; I don't believe it is.
>
> "MR. HARRISON. The answer, I assume, then is 'No'?
>
> "MR. LINDSAY. No.
>
> "MR. HARRISON. Is it intended to eliminate depletion based on presently allowable mining processes performed by mine owners on their own coal which, however, is extracted by independent contractors?

"MR. LINDSAY. It does not get into the question at all."

CONCLUSION

Much of the coal mined in the United States is sold without the application of some or all of the "ordinary treatment processes" listed as being included in "mining," for depletion purposes, in section 114(b)(4)(B)(i) of the Internal Revenue Code of 1939. The question of marketability, however defined, has never been considered by either the industry or the Treasury Department as having any relevance in determining what constitute the allowable treatment processes in computing "the gross income from mining" in the case of coal. Any statement, or even implication, to the contrary in the opinion of this Court in the present case might seriously and adversely affect the interests of the members of the National Coal Association.

The purpose of this brief is simply to urge this Court to avoid such a statement or implication in its opinion relating to the proper methods of computing percentage depletion in the case of fire clay and shale (a controversy which we have no intention of entering into). *Amicus curiae* does not in any way seek an advisory opinion that the present methods of computing coal depletion allowances are correct, but does earnestly request this Court to make clear that the adoption of any contentions of the United States relating to marketability which this Court may decide to accept affects solely the definition of "mining" with respect to the minerals involved in this case.

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No. 518

In the Supreme Court of the United States

OCTOBER TERM, 1959

UNITED STATES, PETITIONER

v.

CANNELTON SEWER PIPE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

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In the Supreme Court of the United States

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No. 513

UNITED STATES, PETITIONER

v.

CANNELTON SEWER PIPE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The District Court wrote no opinion. Its findings of fact and conclusions of law (R. 3–7) are not officially reported. The opinion of the Court of Appeals (R. 266–274) is reported at 268 F. 2d 334.

JURISDICTION

The judgment of the Court of Appeals was entered on June 15, 1959. (R. 275.) By order of Mr. Justice Clark, dated September 10, 1959, the time for petitioning for a writ of certiorari was extended to November 12, 1959. (R. 276.) The petition for a writ of certiorari was filed on November 4, 1959, and was granted on December 14, 1959. (R. 276.) The juris-

diction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Taxpayer, an integrated miner-manufacturer, mines fire clay and shale and, utilizing these minerals, manufactures sewer pipe and other finished products. There is an extensive market for fire clay and shale, but taxpayer does not sell on the mineral market; its mining and transportation costs are high and it would be unprofitable for taxpayer to do so.

Under the Internal Revenue Code, miners of designated minerals are entitled to a depletion allowance determined by applying a specified percentage to the taxpayer's gross income from "mining." "Mining" is defined as including "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *."

The question presented by this case is whether the commercially marketable mineral products, for purposes of determining taxpayer's allowance for mineral depletion, are fire clay and shale (the cut-off point for all non-integrated miners of these minerals) or whether, as held below, taxpayer may include in its gross income from "mining" the proceeds received from sale of sewer pipe and other finished products of its factories.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions and Treasury Regulations are Sections 23(m) and 114(b)(4) of the Internal Revenue Code of 1939 and Section 29.23(m)-

1(f) of Treasury Regulations 111, printed in Appendix A, *infra*, pp. 92–96.

STATEMENT

Taxpayer, an Indiana corporation, has its principal place of business in southwestern Indiana. (R. 4, 195.) During the taxable year ended November 30, 1951, it was engaged in the mining of fire clay[1] and shale and in manufacturing those minerals (in 60–40 proportions) into vitrified sewer pipe, flue lining, wall coping and filter blocks. (R. 4–5.) During 1951, it mined 38,473 tons of fire clay and shale,[2] of which 60 percent (about 23,084 tons) was fire clay. (R. 5.) It sold no raw fire clay or shale, except for 80 tons of clay and shale sold in ground form for $1,822.45. (R. 4–5.) The remainder was used in manufacturing its finished products, the sales prices of which totalled $1,409,145.66. (R. 5.)

Fire clay and shale are used in the manufacture of a variety of different products. In Indiana, for example, fire clay is used in making refractory brick, pottery, structural tile, farm drain tile, face brick,

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[1] Fire clay, for which depletion is allowed at a 15-percent rate, is to be distinguished from brick and tile clay, for which only a 5-percent rate of depletion is allowed.

[2] The fire clay and shale which taxpayer mines is from a geological formation, generally called the Pennsylvania formation, which, in Indiana, is located in the southwestern part of the State extending northward. The same formation extends into Kentucky directly across the river from Cannelton, Indiana. (R. 30, 40.) The fire clay in the formation is known as Pennsylvania underclay and lies directly beneath a thin layer of coal. (R. 5, 24, 118–119.) The shale, which is also a clay but contains some iron and is darker than fire clay when fired (R. 201–204), lies beneath the underclay (or fire clay).

sewer pipe, flue linings, conduit pipe and insulators. Shale is also used for most of those purposes, as well as in the production of cement and for paving brick and lightweight aggregate. (See Ex. A, R. 209.)

Fire clay and shale are produced and sold in large quantities in their raw form. (R. 270.) Thus, in Indiana, in 1951 (the taxable year), more than 500,000 short tons of fire clay were produced, of which over 300,000 tons were sold and the remainder used by the producers thereof. (R. 271.) The United States production (in 31 states, including Indiana) was 11,852,517 tons, of which more than one-fourth (3,159,667 tons) was sold and the remainder used by the producers thereof in making finished products from it. (See Minerals Yearbook (1951), U.S. Bureau of Mines, Department of the Interior, p. 294; see also, R. 136; Ex. A., R. 207.) Substantial amounts of shale were also produced and sold in Indiana (R. 209), as well as in the United States generally.[3] In 1951, seven Indiana producers of fire clay and two Indiana producers of shale engaged in non-integrated operations, that is, strictly in the extraction of the raw fire clay and shale. (R. 270.)

The District Court held that the taxpayer is entitled to take depletion on the total sales ($1,409,145.66) of its finished manufactured products, such as sewer pipe. (R. 6.) In so holding, it found (Fdg.

[3] The shale statistics for the United States, contained in the Minerals Yearbook, *infra*, p. 300, are included under the heading of "miscellaneous clays," of which 27,649,491 tons were produced. Of that amount, 989,739 tons were sold and the remainder was used by the producers thereof. *Ibid.*

10, R. 5): "All of the processes used and applied by plaintiff to the fire clay and shale which it mined and used, were processes normally applied by mine owners or operators who are engaged in the manufacture of vitrified clay sewer pipe and related products."

The Court of Appeals affirmed. Noting that taxpayer's costs are such that it could not profitably sell raw fire clay and shale, the court concluded that taxpayer has a different commercially marketable product than non-integrated members of the same mining industry and that it may take mineral depletion on the basis of the gross proceeds received from sale of its factory output. (R. 266–274.)

SUMMARY OF ARGUMENT

Introduction

Mineral depletion is an allowance for the exhaustion of wasting assets. *Percentage* depletion is a statutory method for ascribing value to those assets. Under this method, a percentage, specified for each mineral by Congress, is applied to "gross income from the property" (in turn, defined as "gross income from mining"); the resulting figure constitutes the allowance.

The dispute in this case relates to the legal criteria by which a taxpayer is to determine what is embraced in "gross income from mining." The relevant statutory provision (Section 114(b)(4)(B) of the 1939 Code) states that "mining" does not include merely the "extraction of the ore or minerals from the ground," but includes also "the ordinary treatment

processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." The same section furnishes some additional guidance, for it specifically lists, in the case of certain minerals (but not those here involved), processes within or outside the concept of "ordinary treatment processes." For example, a coal miner may include "cleaning, breaking, sizing and loading for shipment." A miner of lead, zinc, copper, gold or silver may include, *inter alia*, so-called concentration processes, but *not* smelting or refining.

In the instant case, the court below has permitted taxpayer, a miner-manufacturer who extracts fire clay and shale and converts them into new finished products, such as sewer pipe, to take as the depletion base the gross receipts from the sale of factory output. The court below explicitly found that other miners in taxpayer's own state made substantial sales of raw fire clay and shale. It rested its holding that this taxpayer might nonetheless compute its depletion by reference to the price of manufactured products on a finding (not challenged by the Government) that taxpayer's mining and transportation costs were so high that it could not profitably market the minerals in crude form (a circumstance, we note, which hardly suggests that its mine has great value).

The consequences of this holding are plain. Narrowly viewed, the effect is that taxpayer gets a depletion allowance of over four dollars a ton, whereas a non-integrated miner of fire clay and shale (minerals which sold in Indiana for less than two dollars a ton) would get a depletion allowance of fifteen or twenty

cents a ton. More broadly, the threat is widespread discrimination and dislocation in the economy; virtually unlimited opportunity for some taxpayers to obtain manufacturing subsidies in the guise of mineral depletion; and grave loss to the federal revenue.

We challenge two fundamental propositions which are at the core of the holding below: (1) that the product with reference to which the gross income from mining is computed varies according to the particular product which the taxpayer, on the basis of his particular operation, finds it profitable to sell; (2) that the phrase "ordinary treatment processes normally applied by mine owners or operators" may be extended to take in processes which could never be employed by one who is strictly a mine operator and can only be utilized by one who is also a manufacturer. In doing so, we rely upon the statutory language and terminology and upon a legislative history of some forty years which we believe to be totally irreconcilable with the approach adopted by the Court of Appeals.

I

The statute shows on its face that Congress has adopted a generic or class description—one which imposes an industry-wide test and precludes the individual taxpayer from including such processes as he may use to obtain the particular product which he markets. The statute permits only the inclusion of *ordinary* treatment processes *normally* applied by mine owners or operators. It is normal, to be sure, for an integrated miner-manufacturer to fabricate

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minerals into new products. But it cannot be ordinary or normal for miners, *qua* miners, to employ processes which only an integrated operator would have any occasion to utilize.

This view of the statute is confirmed by the fact that Congress has listed, for specified minerals, certain processes which may constitute "ordinary treatment processes" and others which are excluded from that category. This listing, upon examination, shows that Congress has included only processes which particular segments of the mining industry might have to employ in order to obtain the valuable constituent of the mineral deposit in usable or marketable form. For example, in the case of minerals "which are customarily sold in the form of a crude mineral product," Congress has identified and allowed various processes which might be necessary "to bring to shipping grade and form." In the case of metal mines, it has excluded smelting and refining—processes which take place after the ore concentrate (saleable, at that stage, to smelters) has been obtained.

We emphasize additionally that the concept of "ordinary treatment processes" (as well as the statutory references to particular processes which may satisfy that concept) is in full accord with the mining industry's own view of the scope of mining (a view, as we show under Point II, made fully known to Congress). As the technical treatises and trade journals repeatedly explain, mining, broadly speaking, is regarded as including certain ordinary preparatory processes employed after extraction of the mineral to separate the valuable constituent of the natural deposit from waste

matter. The separation—accomplished by treatment processes variously designated as ore dressing, mineral dressing, milling and beneficiation—yields the valuable mineral in varying degrees of purity or in controlled mixtures. Putting minerals in shipping grade or form may require, in some instances, such preparatory processes as crushing, screening, or drying. The significant point is that the recognized mineral treatment processes do not destroy the physical and chemical identity of the minerals; all of them are distinguished from the processes of manufacture, which involve the mechanical or chemical transformation of inorganic and organic substances into new products.

Accordingly, whether one looks to the general language and scheme of the statute or to the particularized and technical meanings of the terminology incorporated in it, these conclusions emerge: (1) that Congress has adopted a standard applicable to each class of mine, not one that varies from taxpayer to taxpayer; (2) that the treatment processes which are included within "mining" are of a definite and restricted kind, so that there is for each mineral an ascertainable and uniform cut-off point binding upon all miners—integrated or non-integrated—of that mineral; and (3) that the cut-off is at that point where the necessary treatment of the mineral has brought it to the stage where it is fit for sale or commercial use.

II

The legislative history establishes that there is no room for any other interpretation of the statutory definition of "mining."

A. Although percentage depletion was first authorized in 1926 (for the oil and gas industry), provision for depletion of natural deposits dates back to the first income tax statute in 1913. Under the early depletion provisions, it was also necessary to draw lines in order to determine what portion of a taxpayer's income should be deemed to reflect an exhaustion of mining property. Although it was not until 1943 that the statutory definition of mining here in issue was adopted, this definition represents a codification of concepts which had developed over the preceding thirty years. It is accordingly necessary to trace the evolution of mineral depletion from its beginning.

1. (*1913–1924*). The Income Tax Act of 1913 provided that there might be deducted from net income "a reasonable allowance for the exhaustion * * * of property * * * not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year." The Treasury Regulations thereafter provided that "gross value at the mine" meant the market value of the mineral product "at the mine," but that if market value of the product was established at some other place, "transportation, reduction and smelting charges" were to be deducted.

The 1916 Act limited the annual allowance to "the market value in the mine of the product thereof." Under both the 1913 and 1916 Acts, the aggregate of the annual allowances might not exceed the investment in the property or its 1913 value.

In 1918, Congress authorized so-called "discovery" depletion. Under this method, value (which may exceed cost) at or about the time of discovery is esti-

mated and depletion is taken with reference to that figure.

In 1921, the statute was amended to provide that annual depletion could not exceed net income derived from the property during the tax year—a step taken to prevent taxpayers from offsetting depletion allowances against profits earned in other business activities. The implementing Treasury Regulations provided that gross income (from which the net income limitation was to be derived) was to be computed, in the case of the integrated miner, on the basis of "the market or field price of the raw material before conversion [into a refined product]."

In 1924, Congress approved these regulations and set the ceiling on depletion at 50% of "net income * * * from the property."

2. (*1926*). In the mid-1920's, discovery depletion was widely criticized because of the great difficulties involved in appraising the value and capacity of newly discovered mines and the resulting prejudice to many small miners. Percentage depletion was adopted, but solely for the oil and gas industry, in 1926 as a method which would provide "simplicity and certainty in administration." Percentage depletion was to be based on the "gross income from the property." Congress stated, in a joint committee report, that gross income "must be computed from the production and posted price of oil, as the gross receipts from a refined and transported product can not be used in determining the income as relating to an individual tract or lease." Treasury Regulations, in conformity with this declaration, provided that

"gross income shall be assumed to be equivalent to the market or field price of the oil and gas before conversion or transportation."

3. (*1932*). After repeated proposals had been made to several Congresses, beginning in 1927, percentage depletion was extended, in 1932, to metal mines, coal and sulphur. Again, it was urged by proponents that discovery depletion was intolerably difficult to administer and that costly appraisals were beyond the means of small miners. Percentage depletion was urged by the American Mining Congress and others as a simple means of taking account of the economic fact that a portion of the miner's natural deposit is used up in the operation of the mine. The American Mining Congress represented that "gross income from the property" (which had served as the depletion base for oil and gas) has a "definite, fixed meaning" and might be readily applied "in accordance with the trade practice of the different branches of the mining industry." A leading mining association representative stated that percentage depletion "would put us all on the same basis, absolutely." The sulphur representative advised that since sulphur had a market value as produced there would be no need, in the case of that mineral, for "any allocation [between mining and advanced processing] in determining the income to which percentage depletion is applicable."

In its studies of the problem, Congress paid particular heed to the fact that some large metal mine operators performed their own smelting and refining. It concluded that their regular accounting practices would permit them to eliminate the enhancement re-

sulting from smelting and refining and to compute the value of the ore on the same basis "as the smaller operator who sells to a smelter or its agent."

The statute, as passed in 1932, followed the same approach as previously adopted in relation to oil and gas, authorizing depletion in terms of percentages of the "gross income from the property," but not to exceed 50% of the net income from the property.

The Treasury Regulations, which were promptly promulgated, recognized that mining, in trade practice, may extend beyond mere extraction, and they allowed for normal and necessary processing of ore to the marketable stage. Some processes were listed; others were broadly described in the same manner later adopted in Section 114(b)(4)(B). Significantly, special provision was again made for the case of the integrated operator. If there was a representative market price in the area for the basic mineral product of the industry, the integrated operator was to compute his gross income constructively on the basis of that price; if not, the receipts from the sale of the product actually sold were to be reduced by the cost of all extraordinary processes applied.

4. (*1943*). In 1942, mining industry representatives presented two grievances to Congress. The first was that the Treasury Department had departed from the original understanding as reflected in the 1932 regulations and was disallowing certain processes—notably, cyanidation of gold, said to be the equivalent of concentration (a specifically allowed process), and the furnacing of quicksilver, said to be a prerequisite to disposition of that mineral—which were a part of

the necessary preparation of minerals for market. Although it was argued that the Treasury had thus construed "ordinary treatment processes" too restrictively, the mining industry foreswore any purpose to claim depletion on the basis of advanced processes, stating, "Obviously it was not the intent of Congress that those processes which would take your products and make them into different products having very different uses should be considered as the basis of depletion."

The second grievance was that the Treasury, by its 1940 regulations, had taken steps to exclude the profits, as well as the costs, which might be ascribed to advanced processing. These regulations had formulated the so-called "proportionate profits" test (a test which is still called for by Treasury Regulations). Under this test, if a taxpayer engages in advanced or abnormal processing and there is no representative market or field price in the area for the basic mineral product of the industry, there is to be an allocation as between the costs and profits attributable to ordinary treatment processes and those attributable to further processes, the former to constitute the "gross income from the property."

In 1943, Congress, acting in response to the first grievance, wrote the 1932 Treasury Regulations into the statute, adopting the definition of "mining" here in issue and stating (in the words of the Senate Finance Committee):

> The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain

> a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines. * * *
>
> The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions.

Congress refused to modify the proportionate profits computation, a computation which is made under Treasury Regulations *only* where a taxpayer markets a finished product and there is no representative market price for the basic mineral product.

5. (*1943–1954*). In the years since 1943, Congress has retained the same scheme of mineral depletion. Provision has been made for inclusion (subject to certain limitations as to distance) of transportation, but this has been carefully confined to transportation to the point where "the ordinary treatment processes are applied." Percentage depletion has been extended to numerous minerals not previously covered (including fire clay and shale), but without any change in the criteria governing computation of the depletion base. As the Senate Finance Committee observed in relation to certain minerals as to which percentage depletion was proposed in 1949:

> It is not proposed to allow percentage depletion with respect to the value added as the result of grinding or other special preparation

> because many of the extractors do not themselves carry on this process, but rather sell these minerals in crude form and let others carry on any processing required. Thus to allow percentage depletion with respect to this added value would discriminate against those selling these minerals in crude form, since percentage depletion is not allowable to processors.

The latest enactment—the 1954 Code (not directly in issue here)—retains the same basic definition of mining which Congress had evolved over the preceding years.

B. From this history, several propositions emerge clearly. Congress proposed to avoid economic discrimination, particularly against the small miner. To this end, it undertook to establish a uniform standard for determining, in relation to each class of mine, the scope of "mining." Each segment of the industry was to be effectively limited in that its members could include only the ordinary mineral treatment processes customary in the trade and required to put the mineral in its marketable state. From the beginning, Treasury Regulations—regulations which Congress has repeatedly approved—have proceeded on the premise that extraordinary or advanced processing, such as that which might be employed by an integrated operator, would have to be excluded. When the Chairman of the House Ways and Means Committee asked the Chairman of the Tax Committee of the American Mining Congress whether one must be careful in defining mining so as "to separate the value added by manufacturing," the latter replied, "Yes, I think we should."

He further explained that "the ordinary treatment processes which are normally applied to bring your minerals into a marketable condition" were mining and not manufacturing costs.

There is one striking aspect of the legislative history which warrants particular emphasis. Percentage depletion ultimately came to be extended to virtually every significant mineral. Thus, the representatives of almost every branch of mining came before Congress, at one time or another, to state their case. None claimed that mineral depletion might take in manufacturing processes. On the contrary, each undertook to explain to Congress what the basic mineral product was and what processes (if any) were necessary to make that product fit for use or sale. If any of those who urged mineral depletion as a means of compensating miners for the exhaustion of mineral assets secretly contemplated that it might be converted into a bonanza for integrated operators, certainly it did not find expression at any committee hearing.

III

The application of the statute (as we interpret it) to this case presents no difficulty. The court below has found that raw fire clay and shale are sold in substantial quantities—a finding which establishes that fire clay and shale, upon extraction, are marketable mineral products. The error of the court below lies in its conclusion that depletion may be taken on the basis of fabricated products when it appears that the individual taxpayer is not in a position to market the crude mineral product profitably. A mine

does not become more valuable—or entitled to a greater allowance for depletion—because its operating costs are high or its strategic location in relation to the mineral market is poor. Sales are significant for purposes of applying the statute not because an ability to sell profitably is relevant, but only because sales may provide conclusive proof that a mineral product has reached a state where it is fit for commercial or industrial use—proof, in other words, that the mineral has passed beyond the point where it can be said to be undergoing the ordinary processes of "mining."

The *Merry Brothers* group of cases, upon which taxpayer relies, went off on the Government's concession (whether or not such concession was necessary or factually accurate) that the minerals there involved were not sold in their mineral state. Here, of course, the court found as a fact that there is a substantial market for the raw minerals involved.

We note additionally our belief that the legal approach adopted by the courts in *Merry Brothers* and like cases was also mistaken. As our arguments under Points I and II demonstrate, it should make no difference whether a mining industry is non-integrated, partially integrated or fully integrated. The term "ordinary treatment processes" refers to mining processes, and the dependent clause "normally applied * * * to obtain the commercially marketable mineral product" indicates only that miners may claim processes beyond extraction to the extent that such processes are necessary to put the mineral in the condition where it is fit for commercial or industrial use. If

all miners of a particular mineral become integrated, thus providing their own market for the mineral product, the depletion base does not thereby come to comprehend the processes of fabrication and to multiply many times over. Inasmuch as this Court, in this case, will be establishing criteria to which the lower courts will hereafter look in interpreting the statutory definition of "mining," it is, we believe, appropriate that the Court consider the different approaches taken in the decided cases with a view to providing proper guidance for the future.

ARGUMENT

Introduction

Congress has provided a depletion allowance in relation to "mines, oil and gas wells, other natural deposits, and timber" (Section 23(m) of the Internal Revenue Code of 1939, App. A, *infra*, p. 92). As this Court has observed on frequent occasions (*e.g.*, in *Parsons* v. *Smith*, 359 U.S. 215, 220), depletion was designed as an allowance for the exhaustion of wasting assets. *Percentage* depletion (authorized by Section 114(b)(4) of the 1939 Code, App. A, *infra*, pp. 92–94) is simply a statutory method for ascribing value to those assets—a method which was adopted largely because of the difficulties which had been experienced in appraising the value of mineral properties by other techniques. The mechanical or arithmetical aspects of the method are not difficult. Congress has specified various percentages for various minerals.[4] These per-

[4] In the case of fire clay and shale, involved in this case, the percentages are 15 percent and 5 percent, respectively.

centages are to be applied to "gross income from the property" (Section 114(b)(4)(A)), which is in turn defined as "gross income from mining" (Section 114 (b)(4)(B)). The resulting figure represents the amount of depletion which has presumptively occurred; it constitutes the allowance.[5]

The basic problem involved in this case (and in many other cases which are pending administratively or in the courts) is to determine what is included in the concept of "gross income from mining." On this point, the statute states that mining does not include merely the "extraction of the ores or minerals from the ground" (Section 114(b)(4)(B)); it includes also "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products" (*ibid.*). The same section undertakes further to list, in the case of specified minerals, processes which are included in, or excluded from, the concept of "ordinary treatment processes." For example, in the case of coal, "cleaning, breaking, sizing, and loading for shipment" are included. In the case of lead, zinc, copper, gold, silver and certain other minerals, various processes—among them, crushing, grinding and beneficiation by concentration—are included, whereas various other processes—among them, smelt-

[5] There is a ceiling on the allowance. Section 114(b)(4)(A) provides in part: "Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph."

ing and refining—are expressly excluded. The minerals involved in this case—fire clay and shale—are not specifically designated.

The Government's position, advanced in the courts below, is that fire clay and shale are fit for commercial or industrial use in raw form and are in fact sold in that form. The Court of Appeals agreed (R. 270) that "the Government's evidence indicates that large quantities of fire clay and shale were sold during the tax year, 1951." It nevertheless concluded that taxpayer's "gross income from mining"—its depletion base—takes in total receipts from the sale of finished manufactured products, such as sewer pipe, which it fabricates from the ingredient minerals. This was rested upon a finding (which we do not challenge) that taxpayer's costs are such that it could not profitably sell fire clay and shale in their raw form.

Under the Court of Appeals' construction, the scope of mining varies from taxpayer to taxpayer because one must determine, in each instance, what the particular producer can sell at a profit. Indeed, the court expressly recognized (R. 270–271) that the non-integrated miners of fire clay and shale would necessarily be limited, so far as their depletion base was concerned, to the sales price of the minerals in raw form.

Implicit in the court's holding are two fundamental and closely related propositions which, in our view, are erroneous: (1) that the product with reference to which the gross income from mining is computed varies according to the particular product which the

taxpayer, on the basis of his particular operation, finds it profitable to sell; (2) that the phrase "ordinary treatment processes normally applied by mine owners or operators" may be extended to take in processes which could never be employed by one who is strictly a mine operator and can only be utilized by one who is also a manufacturer.

The extreme results to which such a holding leads are readily apparent. Granting that consideration of these practical consequences may not itself be conclusive of the legal issues, the results to which a particular statutory interpretation leads are certainly relevant in determining whether this interpretation is a reasonable one. Thus, we note briefly at the outset the implications of the decision below.

It results, in the first place, in sharp disparities and widespread discrimination. The integrated miner becomes eligible for benefits which must necessarily be denied the non-integrated miner, albeit the statute relates to the depletion of mining properties. In this case, taxpayer, computing depletion on the basis of the sales price of advanced manufactured products, such as sewer pipe, derives a depletion allowance for fire clay and shale amounting to $4.03 per ton. Yet a non-integrated miner in the same area was delivering fire clay and shale to a local manufacturer for approximately $1.40 per ton.[6] His depletion allowance amounts to approximately fifteen cents per ton.[7]

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[6] Sales of fire clay and shale in the Brazil, Indiana, area were at prices ranging from $1.60 to $1.90 per ton. (R. 271.)

[7] For the figures upon which this computation is based, see the Government's petition, pp. 9–10.

Manufacturers who do not own their own mines are also placed at a competitive disadvantage. They cannot obtain the manufacturing subsidies which become available, under the ruling below, to miner-manufacturers.

Finally, there is discrimination among competing miner-manufacturers. Some will be required to take depletion on the basis of a more primitive product than others, for it may be demonstrable that the former can (or do) profitably sell a primitive product.

What has been said in relation to discrimination indicates that there will be a substantial premium placed upon vertical integration and that the type of integration encouraged will be upon a most inefficient basis. The view adopted below rewards the manufacturer who acquires an inefficient mine, for such an acquisition opens the way to his taking depletion upon an advanced manufactured product. It gives rise to what might be termed a Gresham's law of depletion: bad producers drive out good.

Under the Court of Appeals' view, moreover, the possibilities for depletion allowances are virtually limitless. For example, in a case now pending in the Sixth Circuit, *Sparta Ceramic Co.* v. *United States*, 168 F. Supp. 401 (N.D. Ohio), a miner-manufacturer who mines and uses fire clay and shale to make bathroom and floor tile is claiming depletion on the $169 it realized per ton of clay, which is over 50 times the depletion base of a non-integrated clay miner in the same area. A company which mines salt, for which the sales price is about $10 per ton in bulk, is claiming depletion on the sales prices of the salt in the various

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forms in which it is marketed, including four-ounce containers selling at about $1800 per ton. *Morton Salt Co.* v. *United States* (C. Cls., No. 142–58). By the same token, the potential impact upon the revenue is enormous. See petition, pp. 7–8.[8]

From the administrative standpoint, the problems are likewise grave. Congress believed that percentage depletion would provide a simple practical rule susceptible of uniform application.[9] But, under the decision below, the Commissioner may not determine, for each of the various segments of the mining industry, the basic mineral product which establishes the cut-off point. There is no possibility of uniform application. The Commissioner must determine, each year, what products each integrated miner-manufacturer in the United States can, with the particular processes he applies and in the light of his individual facilities and costs, sell at a profit. The difficulties of such investigation and prognosis are so great that the Commissioner, in most instances, would be obliged to presume that the finished products actually manufac-

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[8] We also invite attention to the President's Budget message of January 18, 1960 (reprinted in *The New York Times*, January 19, 1960, p. 17), which stated:

"* * * There is also before the Congress an amendment to prevent unintended and excessive depletion deductions resulting from the computation of percentage depletion allowances on the selling price of finished clay, cement products, and mineral products generally; unless the problem is satisfactorily resolved in a case now pending before the Supreme Court, the need for corrective legislation in this area will continue."

[9] See *infra*, pp. 41–53.

tured by an integrated producer are the only ones which he could profitably market.

We shall argue under Point I that the statute, properly construed, neither requires nor permits these extraordinary results. The definition of "mining," as we read it, imposes an industry-wide test which permits each miner of a particular mineral to include in the depletion base those processes, and only those processes, which are normally required by mine owners to put the mineral in the state where it is fit for commercial or industrial use. It cannot, we think, be fairly interpreted as placing depletion on a basis which varies from taxpayer to taxpayer, much less on one which has the effect of granting a subsidy for manufacturing to those operators who have combined fabrication with mining.

We deal under Point II with the legislative history—a history which has a span of more than forty years and is voluminous. That history, written in large part by members of the mining industry, furnishes overwhelming evidence that depletion was never sought in relation to the manufacture or fabrication of finished products from minerals. Indeed, from the outset, special provision was made for computing the depletion allowance in the case of integrated miner-manufacturers. Congress repeatedly expressed its solicitude that the small non-integrated miner should suffer no disadvantage. Moreover, we find no intimation in the entire history that it was deemed in any way material, from the standpoint of

determining what is included within mining, whether the individual taxpayer could sell the mineral, in its mineral state, at a profit.[10] The purpose of Congress was to allow each miner to include in the depletion base those ordinary processes (by and large, well understood by Congress) which miners normally must apply to put the mineral in a state where it is fit for commercial or industrial use.

In Point III, we consider the particular application to this case of the legal propositions which we believe to be established by an examination of the statute and its history.

I

THE STATUTORY DEFINITION OF MINING ESTABLISHES A UNIFORM STANDARD APPLICABLE TO EACH CLASS OF MINES. EACH MINER OF A PARTICULAR MINERAL MAY INCLUDE IN THE DEPLETION BASE ONLY SUCH ORDINARY TREATMENT PROCESSES AS ARE NECESSARY IN THAT BRANCH OF THE MINING INDUSTRY FOR PURPOSES OF OBTAINING THE BASIC MINERAL PRODUCT FIT FOR COMMERCIAL USE.

The statute, as observed above, provides for the application of specified percentages to "gross income from mining." The crucial language is that which states (Section 114(b)(4)(B)) that mining includes, in addition to the extraction of the ores or minerals from the ground—

[10] The economic implication, of course, if a particular miner could not sell a mineral at a profit, whereas others do so, is that his mine is *less* valuable. It is thus extraordinary to suggest that this circumstance should provide a basis for allowing him, for exhaustion of his mineral property, a *greater* depletion allowance.

> the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable product or products * * *."[11]

On its face, we believe, this language requires the conclusion that Congress has adopted a generic or class description. Congress has not authorized each taxpayer to include such processes as he may use in order to obtain the particular product which he markets. It has authorized only the inclusion of *ordinary* treatment processes *normally* applied by mine owners or operators. We think it inescapable, therefore, that what Congress had in mind was an industry-wide test applicable to each class of mines. The includible processes are those which (1) are "ordinary treatment processes" in the branch of the mining industry concerned, and (2) are necessary in order to obtain, in usable or marketable form, the basic product which such miners wrest from the natural deposits.

The plural reference to products—"the commercially marketable product or products"—is nowise inconsistent with this reading. It is merely a recognition of the fact that one mining operation (as in this case) may yield more than one mineral product (here fire clay *and* shale). Indeed, a single ore frequently con-

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[11] The statutory definition of mining also includes "so much of the transportation of ores or minerals * * * from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical or other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills." This transportation, it is evident, is included as a step which intervenes between extraction and treatment.

tains many different metals. This is reflected in Section 114(b)(4)(B), subparagraph (iv), which speaks of the "processes used in the separation or extraction of the product or products from the ore * * *."

Further evidence of congressional purpose, as found within the four corners of the statute, appears in the listing, for specified minerals, of processes which are eligible for inclusion and processes which are in all events excluded. Section 114(b)(4)(B) goes on to state:

> * * * The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes

> used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. * * *

This listing demonstrates that Congress intended to permit only the inclusion of those processes which are necessary in the particular segment of the mining industry in order to obtain, in usable or marketable form, the valuable constituent of the deposit.

Thus, the treatment processes listed for coal in subparagraph (i)—cleaning, breaking, and sizing—are necessary, at least in the case of anthracite, to put the coal in marketable form.[12]

The processes listed for sulphur in subparagraph (ii) are the required processes for mining sulphur by the commonly utilized Frasch method.[13]

It is sufficient to note, in relation to subparagraph (iii) dealing with minerals customarily sold in crude form, the key words, following the identification of various processes, "to bring to shipping grade and form."[14]

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[12] Richards and Locke, *Textbook of Ore Dressing* (1940 ed.), pp. 501–502; Mitchell, *Coal Preparation*, Seeley W. Mudd Series (1950 ed.), pp. 149, 182–195.

[13] House Hearings, 1932, p. 339 (App. B, pp. 438–439); House Hearings, 1951, p. 1607 (App. B, pp. 440–441). Appendix B to this brief is printed as a separate volume; it is a compendium of legislative and other materials of which the Court may take notice.

[14] At first blush, it may appear inconsistent to state treatment processes for minerals which are customarily sold in the form of a crude mineral product, but this is actually not so. For example, iron ore of shippable grade (at least 50 percent iron) *is* customarily sold without any processing, but taconite, a low-grade iron ore, must be processed. See Senate Hearings, 1942, p. 985 (App. B, pp. 360–361).

The fourth category of ordinary treatment processes (subparagraph (iv)) applies primarily to ores not customarily sold in the form of a crude mineral product. The listed processes include several concentration processes and certain other processes which the mining industry has repeatedly represented as equivalent processes.[15] Concentration is necessary in the case of almost all metallic ores.[16] Even then, the result is not a product which is commercially marketable to the ultimate consumer; the ore still must be smelted or refined (or both) before it is used by fabricators.[17] Numerous miners have smelters and smelt their own ore,[18] but others do not; smelting is a so-called "custom business."[19] Significantly, smelting and refining are expressly excluded from the designation "ordinary treatment processes." The large operator is thus placed in the same category for depletion purposes as the small miner, who sends his ore concentrate to a smelter and is paid what is called the "net smelter return."[20] In short, the cutoff point for ores described in this category is at the conclusion

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[15] See *infra*, p. 59.

[16] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, Economics of the Mineral Industries, (A.I.M.E., 1949 ed.), pp. 62–63.

[17] Taggart, *Handbook of Mineral Dressing* (1945 ed.), p. 2–01.

[18] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, p. 74; Joint Committee Report, 1930, Appendix XXXI, p. 63 (App. B, p. 78).

[19] Tyler, *Cost of Acquiring and Operating Mineral Properties*, Economics of the Mineral Industries (1959 ed.), p. 194; Senate Hearings, 1938, p. 484 (App. B, p. 492).

[20] Shepherd Report, pp. 69–70 (App. B, pp. 83–84); Senate Hearings, 1938, p. 484 (App. B, pp. 492–493).

of the first stage of necessary processing—at that stage where the mined mineral has a marketable value in that it is fit for delivery to a smelter.[21]

It should be pointed out further that the statutory scheme, both in its use of the phrase "ordinary treatment processes" and in the listing of particular processes which satisfy that concept, is in accord with the mining industry's view of the scope of mining—a view, as we shall show in our subsequent discussion of the legislative history of mineral depletion, made fully known to Congress. The technical and the trade literature repeatedly explain that mining embraces certain ordinary preparatory processes, employed after extraction, to separate the valuable constituent from waste matter so as to put it in form or grade fit for use.[22]

To miners, "mining" is a "selective" process of obtaining or winning "a marketable product."[23] It is selective because, in addition to the mineral

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[21] As to the third and fourth categories of listed treatment processes, it should be noted that one or more of these may be applicable to unlisted, as well as listed, minerals. On the other hand, not all apply to any one mineral. For instance, cyanidation is a process used only for treating gold and silver. (See trade definitions, App. B, p. 498.) In general, the listing of ordinary treatment processes covers most, but not necessarily all, of the various treatment processes which are applied in the mining industry. As to any given mineral, "mining" includes only such of the treatment processes (whether listed or unlisted) as are "normally applied by mine owners or operators" to the particular mineral "in order to obtain the commercially marketable mineral product."

[22] See the trade definitions set out in Appendix B, pp. 495–500.

[23] Dickinson, *Depletion—Gross Income—The Property*, 18–19 Mining Congress Journal (1932–1933), October 1932 issue, p. 9 (App. B, pp. 467–468).

for which a deposit is worked, the material mined "usually carries one or several waste minerals" and the "market or use requirement" ordinarily necessitates separation of the valuable mineral, in varying degrees of purity or in controlled mixtures of the components.[24] This separation is accomplished by various "Methods of Treatment" or "Treatment,"[25] depending upon the type of mineral, which do not destroy the physical and chemical identity of the mineral.[26] In the industry, all of these various treatment processes are classified as "mineral dressing,"[27] which is substantially the same as "ore dressing" (mineral dressing as applied to ore),[28] "milling" and "beneficiation."[29] Mineral dressing "is commonly re-

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[24] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, pp. 45, 60.

[25] See Taggart, *Handbook of Mineral Dressing* (1945 ed.), and particularly the page heading "Methods of Treatment" on pages 2–71 through 2–75 and the other numerous "Treatment" page headings. See, also, Fay, *A Glossary of the Mining and Mineral Industry*, Department of Interior, Bureau of Mines (1947 ed.), p. 699, to the effect that a treatment process in mining means a process "whereby the valuable constituent is recovered." Compare *United States* v. *Utco Products*, 257 F. 2d 65 (C.A. 10th); *Commissioner* v. *American Gilsonite Co.*, 259 F. 2d 654 (C.A. 10th), certiorari denied, 359 U.S. 925.

[26] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, p. 62.

[27] Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 4; Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, p. 63; Taggart, *Handbook of Mineral Dressing* (1945 ed.).

[28] Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 1; Stoughton and Butts, *Engineering Metallurgy* (1926 ed.), p. 65.

[29] *Materials Survey—Copper*, U.S. Bureau of Mines with the Cooperation of the Geological Survey, Department of the Interior (Sept. 1952), Ch. II, p. 26.

garded as the processing of raw minerals to yield *marketable products* and waste by means that do not destroy the physical and chemical identity of the minerals."[30] (Italics supplied.) Some mineral materials do not require treatment for waste elimination but may require such preparatory treatment as crushing, screening or drying to meet the minimum marketing requirement.[31] Accordingly, except as to abundant, inexpensive minerals, such as clay,[32] the "winning of a marketable product," which is the "sole objective" of mining,[33] usually requires that the material mined be subjected to certain treatment processes. These processes are considered a part of "mining."[34]

Such processes are also included in "mining" as defined in the Federal Government's *Standard Industrial Classification Manual*,[35] which "defines industries in accordance with the existing structure of the

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[30] Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 1.

[31] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, p. 69.

[32] Ries, *Clay, Industrial Minerals and Rocks*, Seeley W. Mudd Series (1949 ed.), p. 233.

[33] Dickinson, *Depletion—Gross Income—The Property*, *supra* (App. B, p. 467).

[34] See Dickinson, *Depletion—Gross Income—The Property*, *supra* (App. B, pp. 466–468); Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 1; *Encyclopedia Americana* (1958 ed.), Vol. 19, p. 73; *United Mercury Mines Co.* v. *Bradley Mining Co.*, 259 F. 2d 845, 848 (C.A. 9th); cf. *United States* v. *United Verde Copper Co.*, 196 U.S. 207, 212–213.

[35] *Standard Industrial Classification Manual*, Executive Office of the President, Bureau of the Budget, 1957.

American economy" (p. 431). Thus, the *Manual* states (p. 21):

> The term "mining" is also used in the broad sense to include quarrying, well operation, milling (crushing, screening, washing, flotation etc.), and other *preparation needed to render the material marketable.*[36] [Italics supplied.]

Such processing or preparation is entirely discrete from manufacturing. As the *Manual* states (p. 43), the treatment processes employed in mining to obtain a marketable mineral product "are not considered manufacturing" which, in contradistinction to mining, involves "the mechanical or chemical transformation of inorganic and organic substances into *new products.*" [Italics supplied.]

Whether one looks then to the general language and scheme of the statute or to the particularized and technical meanings of the terminology incorporated in it, these conclusions emerge: (1) that Congress has adopted a standard applicable to each class of mine, not one that varies from taxpayer to taxpayer; (2) that the treatment processes which are included within "mining" are of a definite and restricted kind, so that there is for each mineral an ascertainable and uniform cut-off point binding upon all miners—integrated or non-integrated—of that mineral; and (3) that the cut-off is at that point where the necessary treatment of the mineral has brought it to the stage where it is fit for sale or commercial use. The elaborate legislative history, to which we now turn, does not merely

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[36] It was on this basis that the 1954 census of the mining industry was reported. *1954 Census of Mineral Industries*, Vol. 1, p. 2.

confirm these conclusions; it shows, we believe, that no other interpretation of the congressional purpose is possible.

II

THE LEGISLATIVE HISTORY REQUIRES THE CONCLUSION THAT DEPLETION ON THE BASIS ALLOWED BY THE COURT OF APPEALS WAS NOT SOUGHT BY THE MINING INDUSTRY IN ANY OF ITS NUMEROUS APPEARANCES BEFORE CONGRESS AND THAT CONGRESS NEVER PROPOSED TO PERMIT IT.

To place the significant items of legislative history in meaningful context, it is necessary to trace the evolution of mineral depletion from its beginnings. Accordingly, we shall first trace the history chronologically. We shall then state, with brief references to the principal items of proof, the major conclusions which we believe must be drawn.

The various materials to which we shall have occasion to refer in setting out the rather lengthy history are assembled, for the Court's convenience, in a single separate volume—Appendix B to this brief. We have attempted to print the excerpts set forth in the Appendix at sufficient length so that they will appear in their proper setting.[37] We have endeavored, moreover, to gather in this compendium all of the significant materials. This is not to say that we have printed everything which might have even a remote bearing or that we have not eliminated repetitious matter. To print everything said in all of the relevant hearings and reports would take a number of volumes.

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[37] Much of the language to which we make particular reference in the brief has been italicized in the Appendix.

A. The Evolution of Mineral Depletion: Chronological Review

1. The term "gross income from the property," which appears in Section 114(b)(4) and embraces the definition of "mining" here in issue, has a history which dates back almost to the inception of the depletion allowance in 1913. The term was early interpreted in Treasury regulations to refer to the gross income from the crude mineral, irrespective of whether a taxpayer converted or manufactured the mineral into an advanced product or sold it in crude form.

Under the current tax provisions, as noted above, the base to which *percentage* depletion is applied is the "gross income from the property." This has been so since the method of percentage depletion was authorized in 1926. But even earlier than that, in connection with various predecessor depletion provisions, it had been necessary to draw lines in order to determine what portion of a taxpayer's income (whether gross income or net income) should be deemed to reflect an exhaustion of mining property. Thus, in order to make clear the way in which the internal revenue laws on the subject have developed one must begin with the earliest provisions relating to depletion. We note parenthetically that it was not until 1943 that "gross income from the property" was expressly defined by statute as "gross income from mining" and that "mining" itself was accorded a statutory definition. The significance of the early history is that the 1943 definition of mining (which is also the current definition) represents a codification of concepts which had developed over the preceding thirty years.

The first income tax act in 1913[38] provided that in computing net income there should be allowed as a

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[38] Income Tax Act of 1913, Section II B, c. 16, 38 Stat. 114, 116 (App. B, p. 1).

deduction "a reasonable allowance for the exhaustion * * * of property * * * not to exceed, in the case of mines, 5 per centum of the *gross value at the mine* of the output for the year * * *." (Italics supplied.) The Treasury Regulations promulgated under that Act[39] stated that the "gross value at the mine" meant "the market value" of ore, coal, crude oil, and gas "at the mine," but that if the market value of the "product" of the mine or well was established at some other place, then the gross value was to be the value of the ore, etc., *"less transportation, reduction and smelting charges."* (Italics supplied.)

The 1916 Act[40] limited the annual allowance to "the market value *in the mine* of the product thereof, which has been mined and sold during the year." (Italics supplied.) The aggregate depletion deductions allowable under both the 1913 and 1916 Acts were limited to the taxpayer's investment in the property (cost) or its 1913 value.[41]

In 1918,[42] Congress changed the method of computing the allowance and authorized what has commonly been called "discovery" depletion, under which the allowance was based on the fair market value of the property at the time of discovery or thirty days thereafter (a value which, of course, might exceed investment or cost). The purpose of the

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[39] Treasury Regulations 33 (1914 ed.), Art. 142 (App. B, p. 1).

[40] Revenue Act of 1916, Section 5(a), c. 463, 39 Stat. 756 (App. B, p. 2).

[41] Treasury Regulations 33 (1914 ed.), Art. 142 (App. B, p. 1).

[42] Revenue Act of 1918, Section 214(a)(10), c. 18, 40 Stat. 1057 (App. B, p. 3).

change was to stimulate the discovery of critical minerals.[43] Under this method, the present value of the total estimated quantity of minerals in place was computed, a depletion rate per unit of measure was established, and the yearly allowance was based upon the number of units recovered.

In 1921, the statute was amended to provide that the discovery depletion deduction could not exceed the "net income * * * from the property" computed without the allowance for depletion.[44] This was done in order to make certain that the depletion allowance "shall not be permitted to offset or cancel profits derived by the taxpayer from a separate and distinct line of business * * *."[45] The Regulations promulgated in connection with this net income limitation[46] significantly state:

> Net income is the gross income from the sale of all mineral products and any other income incidental to the operation of the property for the production of the mineral products, less operating expenses, * * * but excluding any allowance for depletion. *If the mineral products are not sold as raw material but are manufactured or converted into a refined product, then the gross income shall be assumed to be equivalent to the market or field price of the raw material before conversion.* [Italics supplied.]

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[43] See House Hearings, 1925, p. 161 (App. B, p. 9).

[44] Revenue Act of 1921, Section 214(a)(10), c. 136, 42 Stat. 227 (App. B, p. 5).

[45] S. Rep. No. 275, 67th Cong., 1st Sess., p. 15 (App. B, p. 5).

[46] Treasury Regulations 62 (1922 ed.), Art. 201(h) (App. B, p. 6).

Three years later, in 1924, Congress again considered the net income limitation on discovery depletion and fixed it at 50 per cent of the "net income * * * from the property,"[47] implicitly approving the outstanding administrative interpretation as to "income from the property."[48] This interpretation was continued in the regulations on discovery depletion until that method of depletion was finally eliminated altogether in 1954.[49]

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[47] Revenue Act of 1924, Section 204(c), c. 234, 43 Stat. 253 (App. B, p. 7).

[48] *United States* v. *Dakota-Montana Oil Co.*, 288 U.S. 459, 466; *Murphy Oil Co.* v. *Burnet*, 287 U.S. 299, 302–303; *Brewster* v. *Gage*, 280 U.S. 327, 337. See also *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, 99.

[49] The definition of net and gross income from the property remained unchanged until 1932, when gross income was defined to include mining processes normally applied to obtain a marketable product. See Treasury Regulations 62, promulgated under the Revenue Act of 1921, Article 201(h) (App. B, p. 6); Treasury Regulations 65, promulgated under the Revenue Act of 1924, Article 201(h); Treasury Regulations 69, promulgated under the Revenue Act of 1926, Article 201(h); Treasury Regulations 74, promulgated under the Revenue Act of 1928, Article 221(h); Treasury Regulations 77, promulgated under the Revenue Act of 1932, Article 221 (g) and (h), reprinted in part in Appendix B, pp. 135–138. With some modifications discussed later, the regulations under the 1932 Act continued in force until adoption of the 1954 Code when discovery depletion was abandoned. See Treasury Regulations 86, promulgated under the Revenue Act of 1934, Article 23(m)-1(g) and 23(m)-1(h); Treasury Regulations 94, promulgated under the Revenue Act of 1936, Art. 23(m)-1(g) and 23(m)-1(h); Treasury Regulations 101, promulgated under the Revenue Act of 1938, Article 23(m)-1(g) and 23(m)-1(h); Treasury Regulations 103, promulgated under the Internal Revenue Code of 1939, Section 23(m)-1(f) and 23(m)-1(g); Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939, Section 29.23(m)-1(f) and 29.23(m)-1(g),

Two points may be noted in connection with this early history. *First*, the existence of integrated operators who process, refine and fabricate, as well as mine, the mineral was recognized and dealt with from the very beginning. Then, as under later Treasury Regulations, reference was made to the market or field price of the raw material or to the reduction of gross receipts by the cost of non-mining processes. *Secondly*, the terminology developed in connection with the enactment and administration of the early depletion provisions was later chosen to describe similar concepts in connection with percentage depletion. As will be seen, percentage depletion also came to be limited to 50 per cent of the "net income * * * from the property," and the depletion base came to be defined as the "gross income from the property."

2. Percentage depletion, when adopted in 1926 for oil and gas, was based on the "gross income from the property." As previously, this term was interpreted in Treasury Regulations to require computation of the gross income from the property on the basis of the crude mineral and to preclude discrimination as between integrated and non-integrated producers.

By the mid-1920's, considerable opposition had been expressed to the discovery-value method of computing the depletion base. The valuation required was extremely complex and depended upon many variables since, as earlier noted, it was based on an estimate of the present value of newly discovered mineral deposits.[50] Because of the difficulties and discrimina-

reprinted in part, Appendix A, *infra*, pp. 95-96; Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939, Section 39.23(m)-1(e).

[50] An analytic appraisal, for example, was based on an estimate of the number of units in a deposit, an estimate of the

tory results (small producers were at a disadvantage in making costly appraisals), it was suggested that Congress authorize a simpler and more equitable method of computing the depletion allowance.[51]

Against this background, Congress passed the first percentage depletion statute in 1926.[52] Limited to oil and gas, the statute provided for a deduction of 27½ percent of the "gross income from the property"; it retained the same limitation which had been previously applicable to discovery depletion, namely, that the allowance should not exceed 50 percent of the "net income * * * from the property." The 27½ percent figure was used as representing the average amount of depletion allowed oil and gas operators under discovery depletion as compared with the average gross income from production.[53] It was thought that the percentage system would achieve substantially the

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productive life of the deposit and an estimate of the amount for which the mineral product would be sold when produced. The present value of the right to such prospective income was then computed and a depletion rate per unit established. In any given year, this rate was multiplied by the number of units removed to calculate the depletion allowance. See, generally, Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, S. Rep. No. 27, 69th Cong., 1st Sess., reprinted in part in Appendix B, pp. 11–16.

[51] Senate Hearings, 1926, pp. 153–154, 158, 177–180 (App. B, pp. 17–21); Senate Debate, 1926, 67 Cong. Rec. (Part 4), pp. 3762, 3767 (App. B, pp. 27, 28); see, also, Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, 1926, pp. 55–56, 116 (App. B, pp. 13–15, 15–16).

[52] Revenue Act of 1926, Section 204(c), c. 27, 44 Stat. 9 (App. B, pp. 30–31).

[53] See Senate Debate, 1926, 67 Cong. Rec. (Part 4), pp. 3762, 3763, 3767, 3772 (App. B, pp. 26–29); see, also, Senate Hearings, 1926, pp. 199–200 (App. B, pp. 22–23).

same result without the complexities attending discovery-value computations. Thus, the House Conference Report [34] on the provision stated:

> The administration of the discovery provision of existing law in the case of oil and gas wells has been very difficult because of the discovery valuation that had to be made in the case of each discovered well. *In the interest of simplicity and certainty in administration* the Senate amendment provides that in the case of oil and gas wells the allowance for depletion shall be 30 percent of the gross income from the property during the taxable year. The provision of existing law limiting this amount to an amount not in excess of 50 percent of the net income of the taxpayer from the property is retained. [Italics supplied.]
>
> The House recedes with an amendment providing that the depletion deduction based upon gross income in the case of an oil and gas well shall be 27½ percent of that income instead of 30 percent * * *.

As was true under the earlier laws, the "gross income from the property" (which, under the 1926 law, became the depletion base) was soon defined by regulations to exclude the enhanced value added by manufacturing or converting activities of the taxpayer. (*Infra*, p. 44.)

In 1927, the Joint Committee on Internal Revenue Taxation [35] issued a preliminary report on the expe-

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[34] H. Conf. Rep. No. 356, 69th Cong., 1st Sess., p. 31 (App. B, p. 29); see, also, S. Rep. No. 52, 69th Cong., 1st Sess., pp. 17–18 (App. B, pp. 25–26).

[35] Created by Section 1203 of the Revenue Act of 1926, c. 27, 44 Stat. 9, the Joint Committee consisted of five mem-

rience had with percentage depletion of oil and gas.[36] The report recognized that some operators did not sell the crude product and reasoned that in computing gross income from the property in such situations there would have to be a cutback to measure the income from the basic marketable product of the industry. Thus, the report stated:[37]

> "Gross income from the property" may be defined, therefore for oil and gas properties, as the gross receipts from the sale of oil and gas as it is delivered from the property less the royalties paid in cash, if any. As it is not customary for operators to report oil royalties as a part of their receipts ordinarily, gross income will coincide with gross receipts. * * * *In the case of taxpayers who are operators, refiners, transporters, etc., the gross income from the property must be computed from the production and posted price of oil, as the gross receipts from a refined and transported product can not be used in determining the income as relating to an individual tract or lease.* [Italics supplied.]

The report also noted that "gross income from the property" was a convenient measure because reference to that figure had been necessary to compute the net income limitation under discovery depletion.[38]

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bers of the House Ways and Means Committee and five members of the Senate Finance Committee, charged with the duty to investigate and report on the effect and operation of the federal tax laws.

[36] Joint Committee Report on Depletion, 1927 (App. B, pp. 32–34).

[37] *Ibid.* (App. B, p. 33).

[38] *Ibid.* (App. B, p. 34).

The Treasury Regulations implementing the percentage depletion allowance for oil and gas [59] confirmed the understanding of the Joint Committee that a taxpayer who did not sell the basic product had to compute the allowance as if he had:

> * * * If the oil and gas are not sold on the property but are manufactured or converted into a refined product or are transported from the property prior to sale, *then the gross income shall be assumed to be equivalent to the market or field price of the oil and gas before conversion or transportation.* [Italics supplied.]

The interpretation of the Joint Committee and of the Treasury was later expressly approved by three courts of appeals. See *Brea Cannon Oil Co.* v. *Commissioner,* 77 F. 2d 67 (C.A. 9th), certiorari denied, 296 U.S. 604; *Consumers Natural Gas Co.* v. *Commissioner,* 78 F. 2d 161 (C.A. 2d), certiorari denied, 296 U.S. 634; *Greensboro Gas Co.* v. *Commissioner,* 79 F. 2d 701 (C.A. 3d), certiorari denied, 296 U.S. 639. It was also implicitly approved by this Court in *Helvering* v. *Twin Bell Oil Syndicate,* 293 U.S. 312, 321.[60] These opinions explained that such limitations were necessary to prevent discrimination and to further the obvious intent of Congress. Thus,

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[59] Treasury Regulations 74 (1929 ed.) promulgated under the Revenue Act of 1928, Art. 221(i) (App. B, pp. 64–65).

[60] In the *Twin Bell* case it was stated (p. 321) with respect to "gross income from the property": "The phrase, we think, points only to the gross income from oil and gas. Compare *United States* v. *Dakota-Montana Oil Co.*, 288 U.S. 459, 461; *Greensboro Gas Co.* v. *Commissioner*, 30 B.T.A. 1361."

in *Consumers Natural Gas Co., supra*, Judge Learned Hand traced the statutory development of percentage depletion and concluded that it was intended to be an approximation of capital exhaustion which could not include in its base the value added by post-extraction processes, stating (pp. 161–162):

> * * * Because the formula is rude and imperfect, we are not justified in injecting into the "basis" the added value imparted to the output by work done upon it after it reaches the surface. That cannot fail to make the deviation greater and to introduce a variable which adds a quite unnecessary discrimination to a result arbitrary enough at best.[61]

To summarize, percentage depletion was devised as a system which would lend itself to simple administration and would eliminate the complexities and discriminations of discovery depletion. It was based on the existing concepts of gross and net income from the property. The statutory standard thus adopted was an objective, industry-wide standard uncontrolled by a particular taxpayer's decision to engage in manufacturing or refining activities; the depletion base of the integrated operator, like that of the non-integrated producer, was measured by the market

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[61] Similar language appears in the Third Circuit's opinion in the *Greensboro* case, *supra*, where it was stated (p. 701):

"If, as the taxpayer contends, the allowance was based on the value of its sales of gas to its consumers, the taxpayer would in effect enjoy an allowance for depletion on its distributing system which is already subject to an allowance for depreciation, and it would, since it both produces and distributes natural gas at retail, enjoy an unusual advantage over the mere producer of gas in the field."

value of the first marketable mineral product of the oil and gas industry.

3. When percentage depletion was extended to metal mines, coal and sulphur in 1932, it was again based upon "gross income from the property." Treasury Regulations were again drawn to require all producers of the same mineral to compute depletion on the same basis, albeit they made allowance for the fact that, in relation to these minerals, the basic marketable products are obtained only after the application of certain treatment processes.

The proposal to extend percentage depletion to metal mines was made to the House Ways and Means Committee during its hearings on revenue revision in 1927. The representative of the American Mining Congress urged that depletion for metal mines should be computed, as in the gas and oil industry, on a percentage-of-income basis.[62] The percentage system was urged because it would provide "a simple, definite method, easy of application, that permits the prompt and final determination of the tax liability."[63] It was also urged[64] that it

> removes the discrimination against the large number of smaller taxpayers who do not have the technical staffs or who feel unwarranted in going to the expense of engaging the professional services necessary to the establishment of discovery depletion under the present plan.

In a brief submitted to the Committee, the American Mining Congress repeated that its plan was to give specified minerals the same type of depletion allowance as oil and gas. The brief recommended that

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[62] House Hearings, 1927–1928, pp. 505–512 (App. B, pp. 36–47).
[63] *Id.* at p. 506 (App. B, p. 37).
[64] *Ibid.* (App. B, p. 38.)

"gross income from the property" be used as the depletion base, stating:[65]

> The phrase "gross income from the property" is used in existing statute, and, *if applied in accordance with the trade practice of the different branches of the mining industry,* has a definite, fixed meaning that is well understood in the industry. Fifteen percent of the gross income from the property is accordingly an amount easily and definitely ascertainable. * * * [Italics supplied.]

In 1927, an amendment incorporating the American Mining Congress' recommendation was introduced on the floor of the House, but it was withdrawn on the understanding that the matter would receive additional study.[66]

In 1928, the American Mining Congress made the same recommendation to the Senate Finance Committee.[67] The information supplied the Committee indicated that a study of percentage depletion in respect of minerals other than oil and gas had been undertaken jointly by the Treasury and the Joint Committee and that sufficient data had been gathered to enable Congress to decide on the rate which would afford the mining industries approximately the same quantum of depletion as under the discovery method.

In 1930, the staff of the Joint Committee issued a preliminary report based on the investigations which had been under way since 1927.[68] This study, com-

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[65] *Id.* at p. 510 (App. B, p. 45).

[66] House Debate, 1927, 69 Cong. Rec. (Part 1), pp. 599–600 (App. B, pp. 47–52).
B, pp. 47–52).

[67] Senate Hearings, 1928, pp. 304–317 (App. B, pp. 52–61).

[68] Joint Committee Report, 1930 (App. B, pp. 66–75).

monly known as the Parker Report, noted that there were several alternative methods of simplifying the computation of the depletion allowance; it recommended a method based upon a percentage of *net income from the property.*[69] The report stated that the existing situation under discovery depletion was intolerably difficult to administer and resulted in discrimination both as between mining industries and as between individual miners in the same industry. The preference for *net* income from the property as the depletion base was rested in part upon the fact that this language had been in the discovery depletion laws and was a concept with which the mining industry had become familiar. It was also noted, however, that there had been considerable support for a test based upon percentage of *gross* income from the property. To indicate the details of that proposal, there was appended to the report the brief of the American Mining Congress filed with the Ways and Means Committee in 1927, as well as a report recommending that approach (Appendix XXXI) which had been prepared by a mining engineer of the Joint Committee. Inasmuch as the standard ultimately chosen was a percentage of *gross* income from the property, this appendix, called the Shepherd Report,[70] came to be regarded as the definitive work on the subject.

The Shepherd Report begins by stating that its purpose is to supply data for consideration by Congress in adopting a simplified percentage rate for

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[69] *Ibid.* (App. B, pp. 70–75).

[70] Pertinent portions of the Shepherd Report are also printed in Appendix B, pp. 76–87.

computing depletion.[71] Mr. Shepherd had spent several months collecting data from operators representing 75 per cent of the total production of the industries concerned.[72] This data showed that the average depletion deduction allowed under discovery depletion for metal mines was 17.127 per cent of the "net smelter returns or equivalent."[73] Net smelter return is the payment which a metal miner receives from a smelter and represents the market value of the metallic content of his ores, less transportation and smelting charges.[74] Based on this percentage, the Shepherd Report recommended that 15 per cent of the "gross income from the property," with a 50 per cent net-income limitation, would be a reasonable depletion allowance for metal mines.[75]

The report observed that, as with oil and gas, there would have to be a special provision for integrated operators.[76] After noting that in the case of the small operator almost all of the ore is sold to smelters in the crude or semirefined (concentrate) form so that the gross income from the property would simply be the net smelter return,[77] the report goes on to state that[78]—

> In the case of the large mine operators with complete plants for concentrating, smelting,

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[71] Shepherd Report, pp. 63–64 (App. B, pp. 76–77).

[72] *Id.* at p. 63 (App. B, p. 76).

[73] *Id.* at p. 65 (App B, p. 80).

[74] *Id.* at pp. 69–70 (App. B, pp. 83–84; see also explanation of net smelter return in Senate Hearings, 1938, pp. 484–485 (App. B, pp. 492–493).

[75] Shepherd Report, p. 66 (App. B, pp. 80–81).

[76] *Id.* at p. 68 (App. B, p. 82).

[77] *Id.* at pp. 69–70 (App. B, pp. 83–84).

[78] *Id.* at p. 70 (App. B, p. 84).

refining and marketing, the practice in accounting from a tax-reporting standpoint is more or less the same as the smaller operator who sells to a smelter or its agent.

Most of them do custom work and therefore must keep accounts of the cost of refining ores from their own properties in a similar manner as is done with purchased ores. Therefore the net smelter return basis can apply equally to their own operations.

The report does suggest [79] that in the case of a few metals, where the customary mining practice was to market the *refined* metals, the gross income from the property should be the "competitive market receipts, or its equivalent, received from the sale of the crude, partially beneficiated or refined gold, silver, or copper, the product actually disposed of by the taxpayers to govern the method of computation of receipts in all cases." [80] In the case of all other metals, the suggested rule was that the gross income should be "the competitive market receipts, *or its equivalent*, received from the sale of *the crude products, or concentrates* on an f.o.b. mine, mill, or well basis." (Italics supplied.)[81]

In essence, the Shepherd Report found that the same system that applied to oil and gas could be adapted

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[79] *Id.* at p. 71 (App. B, p. 87).

[80] As will be seen, this suggested rule was not adopted. Instead, these and other "ores which are not customarily sold in the form of a crude mineral product" were limited to certain named treatment processes or their equivalent. Treasury Regulations 77, promulgated under the Revenue Act of 1932, Art. 221(g)(4) (App. B, pp. 135–138).

[81] Shepherd Report, p. 71 (App. B, p. 87).

to metal mines, with some modification to take into account the fact that certain processes are normally applied to the crude ore in order to put it in a marketable state. There was no intimation of any change in the established principle that a taxpayer's manufacturing activities have no effect on the computation of a depletion allowance. Indeed, in later (December 1930) hearings before the Joint Committee,[82] the Treasury opposed the extension of percentage depletion to metal mines on the grounds that there was no established market value for crude ore (as there was with oil and gas) and that operations of integrated taxpayers selling a refined or finished product would create the administrative difficulty of—

> dividing up the resulting income among all those various activities—marketing, transporting, smelting, refining, mining, etc.—and then allocating the proper portion to the mining operation which would be the income from the mine.[83]

The industry representative, however, stated that this objection was unrealistic because computation of both gross and net income from the property had been previously required and because taxpayers and Treasury officials were already familiar with the concepts.[84]

In 1932, the representatives of the metal mining industry again appeared before the committees of Congress seeking extension of percentage depletion, urging that it had worked well for oil and gas and that metal

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[82] Joint Committee Hearings, 1930 (App. B, pp. 88–107).
[83] *Id.* at p. 110 (App. B, p. 105).
[84] *Id.* at pp. 57–58 (App. B, pp. 101–103).

mines were entitled to the same benefits.[55] It was represented that passage of such a statute would not be detrimental to the revenue and might even result in a net gain for the Government since savings of administrative expenses would more than offset any apparent loss of revenue.[56] Citing the Shepherd Report, the metal mining industry said that 15 percent of gross income from the property would be a fair rate.[57] In defending the need for a percentage depletion allowance, these representatives repeatedly urged that the depletion deduction is simply a way of reflecting the economic fact that a portion of a miner's receipts represents a return of capital. For example, it was stated:[58]

> Depletion of mines under our income tax laws means an annual deduction from gross income of an amount which is estimated will compensate the miner for the capital which has been used up or destroyed through the operation of his mine during the year. Obviously all the ore in his mine at the beginning of his operation is capital. Plainly, also, when he takes that ore out of the mine and sells it he has disposed of his capital. * * * The only question which has been considered in past income tax laws, and which is being considered here, is: "What is the proper method of ascertaining the amount of the

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[55] House Hearings, 1932, pp. 327–337 (App. B, pp. 108–112); Senate Hearings, 1932, pp. 224–235 (App. B, 122–129).

[56] Statement of Donald A. Callahan, representing the Northwestern Mining Association, Senate Hearings, 1932, p. 235 (App. B, p. 129).

[57] *Ibid.* (App. B, p. 129).

[58] *Id.* at p. 225 (App. B, p. 123).

proceeds of his sales of ore which may be regarded as return of capital and upon which he should pay no tax?"

It was again stressed that percentage depletion was absolutely necessary to eliminate existing discrimination between taxpayers. "The adoption of this plan would put us all on the same basis, absolutely." [89]

Spokesmen for the coal industry advanced the same contentions and argued additionally that the coal industry was severely depressed and needed tax relief.[90] They also urged that, since a large segment of the coal industry was producing captive tonnage which was sold on the basis of cost, percentage depletion should be tied to gross income from the property, rather than net income therefrom.[91]

The sulphur representatives testified [92] that percentage depletion would be particularly suitable to that industry because sulphur was prospected for and produced much like oil and gas and frequently came from the same property or type of deposits. It was stressed that sulphur had a market value as it was produced, thus eliminating "any allocation in determining the income to which percentage depletion is applicable." [93]

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[89] *Id.* at p. 230 (App. B, p. 125).

[90] Brief of the National Coal Association and sundry district associations of bituminous mine operators, House Hearings, 1932, pp. 342–346 (App. B, pp. 117–122). This brief was also submitted to the Senate Finance Committee, Senate Hearings, 1932, pp. 236–242 (App. B, pp. 129–130).

[91] House Hearings, 1932, p. 345 (App. B, p. 120).

[92] Statement of E. T. Cummins, representing domestic sulphur producers and brief on behalf of sulphur producers, House Hearings, 1932, pp. 337–341 (App. B, pp. 113–117).

[93] *Id.* at p. 341 (App. B, p. 116).

As enacted,[94] the statutory authorization of percentage depletion for coal, sulphur and metal mines followed the same approach as the oil and gas provision of the 1926 Act and was stated simply in terms of percentages of the "gross income from the property," but not to exceed 50 percent of the net income from the property. Again, the meaning of that term was left to administrative definition.

As pointed out both at the hearings and in the Parker and Shepherd Reports, application of the "gross income from the property" base to metal mines was not as easy as it had been with oil and gas, which is marketable as it comes from the well.[95] Most metallic ores require treatment to remove some of the extraneous matter or waste before they can be sold or transported to a smelter.[96] The processes by which this is done—in the industry, covered by the various terms "beneficiation," "concentration," "mineral dressing," and "ore dressing"—are means of separating out waste material without changing the physical or chemical identity of the mineral.[97] These processes are applied by the miners themselves. After beneficiation, the normal procedure, as Congress was advised,

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[94] Revenue Act of 1932, Section 114(b)(4), c. 209, 47 Stat. 169 (App. B, pp. 133–134).

[95] Joint Committee Hearings, 1930, p. 50 (App. B, p. 101); Joint Committee Report, 1930, p. 68 (App. B, p. 82).

[96] Behre and Arbiter, *Distinctive Features of the Mineral Industries*, *supra*, pp. 45, 60.

[97] For trade definitions of "beneficiation" and "concentration," see App. B, p. 496. "Mineral dressing" includes "concentration," and "ore dressing" is mineral dressing applied to ores. Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 1.

is to ship the ore concentrates to the smelter, who then remits the value of the mineral content of the shipment to the miner based on the market price of the metal, but less the smelter's charge for treatment."

The drafting of the interpretative regulations was begun shortly after the passage of the 1932 Act and was completed only after protracted consultations with industry representatives, particularly the spokesmen of the American Mining Congress.[2] These regulations were later codified [1] and are therefore of particular significance.

Initially, the Treasury rejected the net smelter return standard proposed by the industry and supported by the Shepherd and Parker Reports.[2] Ultimately,

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[2] See Senate Hearings, 1938, pp. 484–485 (App. B, pp. 491–492).

[2] See Fernald, *Depletion and Related Problems under the Revenue Act of 1942*, 21 Taxes, The Tax Magazine, p. 141 (1943) (App. B, p. 483); Statement of Donald H. McLaughlin, representing the Tax Committee of the American Mining Congress, Senate Hearings, 1943, p. 527 (App. B, p. 202); Statement of Henry B. Fernald, Chairman, Tax Committee, American Mining Congress, Senate Hearings, 1950, p. 781 (App. B, pp. 278–279).

[1] See *infra*, pp. 58–64.

[2] The American Mining Congress submitted several memoranda to the Treasury Department during the consideration of these regulations, setting forth its views on the proper application of the statute. A memorandum dated November 29, 1932, signed by H. B. Fernald, Chairman, Tax Committee, suggested as a possible alternative to the "net smelter return" concept an interpretation based on the gross receipts of the individual taxpayer regardless of the stage at which he sold his product. This proposal, along the lines suggested in the Shepherd Report (App. B, pp. 76–87) for metallics usually sold in refined form, was that—

* * * "For the purpose of this subdivision 'the gross income

however, it acceded to the view that the normal and necessary processing of ore to the marketable stage should be included in computing gross income from the property. The Treasury Regulations promulgated under the 1932 Act [3] adopted this standard. They take the position that "gross income from the property" includes the preparation or treatment processes normally applied and necessary to obtain a marketable product.[4] Thus, the includible treatment processes were listed for certain minerals; others were broadly described in the same manner later adopted in Section 114(b)(4)(B). "Gross income from the property" was defined in the regulations as the amount for which the taxpayer sold the crude mineral product or the product derived therefrom, but not to exceed the amount which would have been received if different

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from the property' shall be the competitive market receipts, or their equivalent, received from the sale of the crude, partially beneficiated, or refined metal, the product actually disposed of by the taxpayer to govern the method of computation of receipts in all cases."

However, the memorandum went on to state that a net smelter return basis would be preferable because the alternative would be—

"subject to the possible objection that it might not give the same depletion base to all the taxpayers in any particular division of the industry, but one might receive more and another less according to the particular way in which it happened to dispose of its product. Also it may be urged that such a regulation would not be in accord with the regulations as to oil which require the use of the basis on which oil production is ordinarily sold in that industry, regardless of how a particular taxpayer may dispose of its own product."

[3] Treasury Regulations 77, Art. 221(g) (App. B, p. 135).

[4] See discussion in fn. 2, *supra*, pp. 55–56.

or advanced (*i.e.*, other than normally required) processing had not been applied. If there was a representative market or field price in the area for the basic marketable product of like kind and grade, that was to determine, for the integrated producer, the gross income from the property. If not, the receipts from the sale of the product actually sold were to be reduced by the cost of all the extraordinary processes applied.

The alternative methods of computing the depletion base of integrated operators—representative market price or exclusion of processing costs—were the same as previously used for the same purpose for oil and gas, and, earlier, in applying the percentage limitation under the 1913 Act. Additional processing after the marketable stage had not been included in "gross income from the property" in the case of oil and gas, and the same principle was purposefully adopted for the new minerals.[5] This was fully recognized in the mining industry after passage of the 1932 Act. In an article appearing in the October 1932 issue of the Mining Congress Journal written by a member of the staff of the American Mining Congress,[6] it was stated:

> It is generally understood that gross income is the amount of money received for, or the value of the marketable or shipping product of, a natural resource enterprise. The production

[5] See, *e.g.*, Joint Committee Hearings, 1930, p. 50 (App. B, p. 101); House Hearings, 1932, pp. 339–340 (App. B, pp. 115–116).

[6] Dickinson, *Depletion—Gross Income—The Property*, 18–19 Mining Congress Journal (1932–1933), October 1932 issue, p. 9 (App. B, p. 467).

of coal or ore, of metals or non-metals is carried on from the prospecting and discovery stages with the sole objective of developing and bringing into being a marketable shipping product of value. This value is the gross income.

4. ***The statutory definition of "gross income from the property," including the definition of "mining", was added to Section 114(b)(4) in 1943 at the request of the mining industry, and made retroactive to 1932, as a ratification and codification of the original administrative practice under the 1932 Treasury Regulations and in confirmation of the prior understanding of the mining industry that the allowed processes included all which were necessary in order to make the mineral fit for commercial use.***

After the extension of percentage depletion (in 1932) to metal mines, coal and sulphur, and the issuance of the interpretative regulations, there were no significant legislative or administrative developments for several years. During this interval the Revenue Acts of 1934,[7] 1936,[8] and 1938[9] and the Internal Revenue Code of 1939 were successively passed with only minor (and here irrelevant) amendments to the percentage depletion provision.

However, in 1942, industry representatives appeared before the committees of Congress[10] complaining of two modifications of the Treasury's prior prac-

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[7] Revenue Act of 1934, Section 114(b)(4), c. 277, 48 Stat. 680.

[8] Revenue Act of 1936, Section 114(b)(4), c. 690, 49 Stat. 1648.

[9] Revenue Act of 1938, Section 114(b)(4), c. 289, 52 Stat. 447.

[10] House Hearings, 1942, pp. 1169–1202 (App. B, pp. 147–153); Silver Subcommittee Hearings, 1942, pp. 731–766, 812–814, 858–864, 999–1039 (App. B, pp. 154–191); Senate Hearings, 1942, pp. 969–973, 1311–1323 (App. B, pp. 192–195).

tice which had allegedly occurred in the late 1930's and in 1940.

The first grievance was that the Treasury had begun to exclude from the gross income computation certain processes, such as the furnacing of quicksilver ores and the cyanidation of gold, which the mining industry believed to be the equivalent of beneficiation processes allowed under the 1932 Regulations. It was stated that quicksilver could not be marketed without furnacing it,[11] and it was urged that the cyanidation of gold was a process which the Treasury had previously considered equivalent to concentration (a specifically allowed process).[12] In support of this claim that the Treasury was disallowing processes which were a part of the necessary preparation of the mineral for market, reference was made[13] to the Parker and Shepherd Reports to show the guiding purpose with which Congress had acted in 1932. No suggestion was made that the gross income from the property should be computed on the basis of advanced or manufactured products. On the contrary, a principal industry witness at one of the hearings stated[14]—

> Obviously it was not the intent of Congress that those processes which would take your products and make them into different products having very different uses should be considered, as the basis of depletion.

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[11] House Hearings, 1942, p. 1199 (App. B, p. 152).

[12] Silver Subcommittee Hearings, 1942, pp. 813, 861, 1010 (App. B, pp. 170–171, 177, 188–189).

[13] House Hearings, 1942, p. 1170 (App. B, p. 148).

[14] Silver Subcommittee Hearings, 1942, p. 764 (App. B, p. 166).

The mining industry's other complaint [15] was that Treasury Regulations had been amended in 1940 [16] so as to require the exclusion of *profits,* as well as the *costs,* attributable to advanced processing.[17] The 1940 regulations in question had adopted the so-called "proportionate profits" test (a test which is still provided for in Treasury Regulations [18]). It provides in substance that if a taxpayer uses processes which go beyond ordinary treatment processes and there is no representative market or field price for the basic mineral product of like kind and grade, there shall be an allocation as between the costs and profits attributable to ordinary treatment processes and those attributable to further processing, the former to constitute the "gross income from the property."

Congress passed the 1942 Act without taking action on either of the complaints, although, by that statute, it added fluorspar, rock asphalt and ball and sagger clay to the minerals entitled to the depletion allowance.[19] During Senate consideration of the bill, how-

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[15] See Silver Subcommittee Hearings, 1942, p. 1008 (App. B, p. 186).

[16] T.D. 4960, approved January 3, 1940 (1940–1 Cum. Bull. 38), amending Treasury Regulations 101, which had been made applicable to the Internal Revenue Code of 1939 by T.D. 4885 (1939–1 Cum. Bull. (Part 1) 396). This was continued in Treasury Regulations 103 (1940 ed.), Sec. 19.23(m)–1, promulgated under the Internal Revenue Code of 1939 (App. B, pp. 142–147).

[17] Silver Subcommittee Hearings, 1942, p. 1010 (App. B, pp. 188–189).

[18] See Treasury Regulations 111, Sec. 29.23(m)–1, App. A, *infra,* pp. 95–96.

[19] Revenue Act of 1942, Section 145(a), c. 619, 56 Stat. 798 (App. B, p. 198).

ever, there was a discussion between Senator Johnson of Colorado and Senator Thomas of Idaho as to the industry complaints. Senator Johnson reported that the Treasury had agreed to modify its practice with respect to disallowing equivalent processes, but would continue to exclude profits as well as costs attributable to excluded processes. This colloquy confirmed that it had been the original intent of Congress in 1932 that "the ordinary treatment processes which a mine operator would normally apply in order to obtain a suitable product should be considered as part of the mining operation." [20]

In 1943, the House added certain critical minerals to the statute, allowing them percentage depletion on a temporary basis.[21] The Senate Finance Committee held hearings on the House bill, and several industry representatives appeared in support of an amendment introduced by Senator Johnson dealing with the problems discussed in 1942.[22] This amendment, which was later enacted in part, dealt with both of the grievances discussed earlier. It provided that mining should extend to "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product," and it specified, in conformity with the 1932 Treasury Regulations, what these processes would be for certain

[20] Senate Debate, 1942, 88 Cong. Record (Part 6), p. 8033 (App. B, pp. 196–198).

[21] See H. Rep. No. 871, 78th Cong., 1st Sess. (App. B, pp. 199–200).

[22] Senate Hearings, 1943, pp. 527–529, 785–786, 926–928 (App. B, pp. 201–209).

classes of mines.[23] The proposed amendment also contained a provision (not enacted) that only the costs of any process or service which does not constitute an "ordinary treatment process" shall be excluded in computing the gross income from the property.[24]

The American Mining Congress supported the Johnson amendment as a proper interpretation of the original intent of Congress and the administrative practice under the 1932 Regulations, stating:[25]

> The proposed amendment simply incorporates in the law the practices established by the Bureau under the 1932 regulations, and does not modify the existing regulations in any essential way except to limit the deductions in calculating gross income to the costs of the processes or services subsequent to those which are regarded as ordinary treatment processes and specified as such.

The Senate Finance Committee adopted this amendment, declaring:[26]

> The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and

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[23] This portion of the amendment became law and is the definition of "mining" to be construed in the present case.

[24] The text of the Johnson amendment is set forth in the Senate Hearings, 1943, p. 529 (App. B, pp. 205–207).

[25] Statement of Donald H. McLaughlin, representing the Tax Committee of the American Mining Congress, Senate Hearings, 1943, p. 528 (App. B, p. 204).

[26] S. Rep. No. 627, 78th Cong., 1st Sess. (App. B, pp. 210–211).

> to give reasonable specification of what are to be considered such processes for various kinds or classes of mines. * * *
>
> * * * The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions.

The Senate adopted the Johnson amendment without significant change and the bill went to conference. There, the House receded with two amendments.[27] The first deleted the Senate provision which would have allowed the inclusion in the depletion base of profits attributable to advanced processing. The second made express provision for excluding certain processes, *i.e.*, electrolytic deposition, roasting, thermal or electric smelting and refining, from the classification "ordinary treatment processes." As so amended, the bill passed.

It thus appears that Congress, in 1943, approved and codified the original regulations and practice whereby "gross income from the property" had been restricted to gross income obtained (or obtainable) from sale of the basic mineral product of the particular mining industry. In doing so, Congress made the statute retroactive to 1932. It is especially notable (1) that Congress, in defining and in listing (for designated minerals) "ordinary treatment processes,"

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[27] H. Conference Rep. No. 1079, 78th Cong., 2d Sess., pp. 20–21, 50–51 (App. B, pp. 219–222).

did so on a class or industry basis, not on a taxpayer-by-taxpayer basis; and (2) that Congress specifically refused to modify the proportionate profits computation, a computation which is made under Treasury Regulations *only* where a taxpayer markets a finished product and there is no representative market price for the basic mineral product.

5. *Since the enactment of the statutory definition in 1943, Congress has consistently interpreted the statutory standard in accordance with the guiding purposes expressed in 1932 and 1943.*

Although, since 1943, Congress has repeatedly considered proposals to modify the definitive criteria of the statute, the only change adopted was in 1950 when transportation of the mineral from the point of extraction to the place where the ordinary treatment processes are applied was expressly included in the definition of mining.[28] This provision apart, there is no indication that Congress has desired, in any way, to broaden the scope of mining, much less to abandon the settled distinction between mining and manufacturing. The evidence is to the contrary.

The next congressional consideration of the depletion allowance was in 1947 when the temporary wartime allowance for certain non-metallic minerals was made permanent and the allowance was extended to certain competitive minerals.[29] In seeking this legislation, the industry representatives requested the allowance on the same basis as oil and gas and other

[28] Revenue Act of 1950, Section 207, c. 994, 64 Stat. 906 (App. B, p. 287).

[29] Act of August 8, 1947, c. 515, 61 Stat. 917 (App. B, pp. 240-241).

minerals; the hearings,[30] the committee reports [31] and the debates [32] make it clear that the purpose of the allowance and the method of computation were to remain unchanged. The 1947 Act continued the existing standard;[33] it may also be viewed as a further legislative ratification of the outstanding regulations, which had been slightly modified after the 1943 Act.[34]

During House Hearings on Revenue Revisions, 1947–1948,[35] the American Mining Congress proposed that a definition of "*net* income from the property" (italics supplied) be added to the Code, allegedly because the Treasury practice had again strayed from "the original intent of these provisions or from the Bureau's practice of earlier years." Although the Ways and Means Committee took no action, the proposal itself indicates that the industry was not challenging the definition of *gross* income from the property.

In 1949, in connection with its consideration of the Technical Changes Act of 1949,[36] the Senate passed an

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[30] House Hearings, 1947 (App. B, pp. 241–245).

[31] H. Rep. No. 802, 80th Cong., 1st Sess. (1947–2 Cum. Bull. 353), pp. 2, 9 (App. B, pp. 235–236); S. Rep. No. 693, 80th Cong., 1st Sess. (1947–2 Cum. Bull. 359) (App. B, p. 238).

[32] House Debate, 1947, 93 Cong. Rec. (Part 8), pp. 9626–9628 (App. B, pp. 236–237).

[33] The Senate added an amendment specifying the ordinary treatment processes for potash and thenardite, which was stricken at conference, leaving the matter to be determined under existing law. H. Conf. Rep. No. 1097, 80th Cong., 1st Sess., p. 3 (1947–2 Cum. Bull. 360) (App. B, p. 239).

[34] Treasury Regulations 111, as amended by T.D. 5413, approved October 31, 1944 (1944 Cum. Bull. 124), Section 29.23(m)–1(f) (App. B, pp. 226–229).

[35] App. B, pp. 243–245.

[36] Act of October 25, 1949, c. 720, 63 Stat. 891.

amendment which would have extended percentage depletion to a number of named minerals and to "all other nonmetallic clays and minerals." [37] Although this was dropped in conference, with the understanding that the matter would be taken up the following year, it is significant that a broad extension of the allowance to numerous additional minerals was not thought to require any modification of the method of computing the allowance. In fact, the Senate Finance Committee Report stated: [38]

> It is not proposed to allow percentage depletion with respect to the value added as the result of grinding or other special preparation because many of the extractors do not themselves carry on this process, but rather sell these minerals in crude form and let others carry on any processing required. Thus to allow percentage depletion with respect to this added value would discriminate against those selling these minerals in crude form, since percentage depletion is not allowable to processors.

In 1950, the House considered the requested extension of the allowance to additional minerals as promised by the House conferees in 1949. After extensive hearings,[39] the Ways and Means Committee proposed extension of the allowance to a number of minerals because they were "competitive with the minerals receiving percentage depletion or have just as good a

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[37] The text of this amendment is summarized in H. Conf. Rep. No. 1412, 81st Cong., 1st Sess., p. 11 (App. B, p. 248).

[38] S. Rep. No. 831, 81st Cong., 1st Sess., p. 10 (App. B. p. 247).

[39] House Hearings, 1950 (App. B, pp. 249–264).

claim for such treatment as the enumerated minerals."[40] The Committee also proposed[41] the adoption of a Treasury recommendation on allowable transportation—

> * * * In order to restrict depletion to the actual product of mineral extraction, it is stipulated in your committee's bill that the gross income to which the percentage depletion rate is to be applied shall not include income resulting from the transportation of the product beyond the property.

During House debates, objection was made to the transportation exclusion as being too restrictive where it applied to transportation before the product was rendered marketable, but the Committee bill was approved.[42] At the Senate Finance Committee hearings on the House bill, industry representatives complained of this provision, urging that it be amended to allow transportation to the place where "ordinary treatment processes were applied," since the ordinary treatment processes determined what was and was not mining under the statute.[43] The representations of the industry were again couched in terms of the existing standard of what constituted gross income from the property. In speaking of the existing interpreta-

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[40] H. Rep. No. 2319, 81st Cong., 2d Sess., p. 64 (App. B, p. 265).

[41] *Id.*, p. 65 (App. B, p. 266).

[42] House Debate, 1950, 96 Cong. Rec. (Part 7), pp. 9282–9283 (App. B, pp. 266–269).

[43] Senate Hearings, 1950, pp. 301–302, 447–449, 771–785 (App. B, pp. 269–281).

tion, the American Mining Congress representative explained: "

> * * * Transportation necessary to move the minerals to the plants where the ordinary treatment processes were performed was, like the processes themselves, to be considered as a part of mining. Transportation from the place where the last of the specified processes was applied was not to be considered as part of mining; nor were any further processes beyond those specified. * *The processes specified gave the cut-off point between what was and what was not to be considered mining in each case.*
>
> We are confident that Congress, in adopting the 1943 amendment to express the intent of the prior law, intended that the definition of "gross income" written into the law should carry the same meaning and *the same cut-off point* with regard to transportation as had been set forth in the early regulations and had been followed in Bureau procedure. [Italics supplied.]

The Senate adopted this view and amended the House bill accordingly.[45] In conference, the House receded with an amendment limiting transportation to 50 miles, unless the Secretary approved a greater distance.[46] On this basis, the transportation provision

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[44] Statement of Henry B. Fernald, Chairman, Tax Committee, American Mining Congress, Senate Hearings 1950, p. 771 (App. B, p. 275).

[45] S. Rep. 2375, 81st Cong., 2d Sess., pp. 52–53 (App. B, pp. 282–283).

[46] H. Conf. Rep. No. 3124, 81st Cong., 2d Sess., p. 26 (App. B, pp. 284–285).

was enacted. The Senate again postponed the extension of the depletion allowance to additional minerals.

The Revenue Act of 1951[47] contains the last amendment of the percentage depletion provisions of the 1939 Code. This Act merely extended the allowance to a number of minerals, including fire clay and shale, at varying rates of depletion; it did not modify the method of determining the base to which these rates were to be applied. It is again significant that the extension of the allowance was requested on the basis of the *first* marketable product in the *industry*, and not by reference to a particular taxpayer's marketed product.[48]

The chronological account of the legislative history ends with the congressional deliberations preceding the adoption of the Internal Revenue Code of 1954. Although the pertinent provision of that Code is not in issue here, it is to be observed that the basic definition of mining remains the same in the 1954 Code.[49]

B. Controlling Propositions Established by the Legislative History

In the preceding section, we have recounted chronologically the development of percentage depletion.

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[47] Revenue Act of 1951, Section 319, c. 521, 65 Stat. 452 (App. B, 307–308).

[48] See discussion *infra*, pp. 78–80.

[49] Internal Revenue Code of 1954, Section 613. See H. Rep. No. 1337, 83d Cong., 2d Sess., p. 58, A185 (App. B, pp. 312–314); S. Rep. No. 1622, 83d Cong., 2d Sess., p. 79, 332 (App. B, pp. 314–316); H. Conf. Rep. No. 2543, 83d Cong., 2d Sess., pp. 52–53 (App. B, p. 316).

The main themes which run through the lengthy course of the congressional deliberations are evident. Nonetheless, it may be useful to formulate those propositions, important for present purposes, which emerge from that history and to restate briefly what we consider to be the compelling items of proof.

1. *Congress proposed to avoid economic discrimination, particularly against the small miner.*

Under the decision below, an integrated sewer-pipe manufacturer takes depletion for fire clay and shale on the basis of the gross income received from the sale of manufactured sewer pipe, realizing an allowance of $4.03 per ton (almost three times the market price which those minerals command). A non-integrated miner of the same minerals obtains a depletion allowance of approximately fifteen cents per ton.[30] Yet the legislative history establishes, in our view, that Congress proposed to put all miners, large and small, on an equal footing.

The percentage method of measuring depletion allowance was devised and justified as a means of eliminating discrimination as between various segments of the mining industry and as between miners in each group or class. The industry has repeatedly urged it as a fair and equitable method of measuring the exhaustion of capital assets. And the allowance has been progressively extended to new minerals on the basis of representations that it was necessary to do so in order to eliminate competitive injuries suffered

[30] Competing manufacturers (who receive no subsidy), and miner-manufacturers (those, for example, who have low-cost mines) are subject to similar prejudice.

by those classes of mines which did not enjoy the privilege.

We note the following items:

Percentage depletion for the oil and gas industry was urged and enacted (in 1926) primarily on the ground that it would eliminate discrimination against small producers which had resulted from the burdens involved in establishing discovery value.[51]

Coal, sulphur and metal mine representatives sought depletion for their respective industries because it "removes the discrimination against the large number of smaller taxpayers who do not have the technical staffs or who feel unwarranted in going to the expense of engaging the professional services necessary to the establishment of discovery depletion"; because, under percentage depletion, "the small operator would in practice as well as in theory receive the same treatment as the large corporation"; and because the adoption of percentage depletion "would also remove the discrimination now existing against the mining industry as compared with the oil and gas industry."[52]

[51] See Senate Hearings, 1926, p. 177 (App. B, p. 19); see, also, Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, p. 116 (App. B, p. 15).

[52] House Hearings, 1927–1928, pp. 506, 511 (App. B, pp. 38, 46). There are many other statements of like tenor. See Parker Report (Joint Committee Report, 1930, pp. 2, 12 (App. B, pp. 70, 72)); Shepherd Report (Joint Committee Report, 1930, p. 63 (App. B, pp. 76–77)); Joint Committee Hearings, 1930, pp. 30–34, 94–95 (App. B, pp. 97–98, 104–105); House Hearings, 1932, pp. 327–328, 329, 342–343 (App. B, pp. 108–109, 110, 118–119); Senate Hearings, 1932, pp. 229–230, 231–232 (App. B, pp. 125–127); House Hearings, 1934, p. 393 (App. B, p. 140); House Hearings, 1942, pp. 1184–1185 (App. B, pp. 150–151); House Hearings, 1951, pp. 1573, 1582 (App. B, pp. 292, 295).

The successive extensions of percentage depletion to other minerals, beginning in 1942, was similarly urged and adopted on the ground that such minerals were competitive with minerals which had been already accorded percentage depletion.[53] Thus, fire clay, one of the minerals involved in this case, was accorded percentage depletion in 1951 only after industry representatives testified that it was competitive with other types of clay which had been granted the privilege.[54]

2. Congress proposed to avoid discrimination by establishing a uniform standard for determining, in relation to each class of mine, the scope of "mining."

In support of this proposition, we stress the following:

In 1913, Congress limited depletion to 5 percent of the value of the mineral product at the mouth of the mine. The implementing Treasury Regulations required that, when the mineral was sold elsewhere, the

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[53] See, generally, H. Rep. No. 2333, 77th Cong., 2d Sess., p. 92 (App. B, pp. 153–154); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 115 (App. B, p. 195); H. Rep. No. 802, 80th Cong., 1st Sess., p. 9 (App. B, pp. 234–236); H. Rep. No. 586, 82d Cong., 1st Sess., pp. 29, 114 (App. B, pp. 296–298); S. Rep. No. 781, 82d Cong., 1st Sess., pp. 37–38 (App. B, pp. 299–302). See, also, the material in Appendix B, Part II, in connection with the following minerals: asbestos, bentonite, borax, fire and refractory clay, quartzite, diatomaceous earth, fuller's earth, stone, chemical and metallurgical grade limestone, perlite, rock asphalt, slate, trona, vermiculite, and wollastonite (App. B, pp. 316–318, 320–326, 335–342, 348–349, 352–353, 363–394, 395–396, 407–413, 423–432, 454–466). Competitive reasons for the extension of percentage depletion were offered in each instance.

[54] The testimony was that fire clay competes with sagger clay, bauxite, china clay, ball clay, bentonite, vermiculite. House Hearings, 1950, p. 453 (App. B, pp. 338–339).

costs of processing beyond the mine and of transportation should be excluded.[55]

In 1922, the Treasury ruled that gross income for an integrated operation was to be determined by "the market or field price of the raw material before conversion."[56] With full Congressional approval, the same principle was later applied by the Treasury in administering percentage depletion in the oil and gas industry.[57]

The crucial 1932 Treasury Regulations, relating to metal mines, coal and sulphur, undertook once again to restrict producers to the ordinary treatment processes of mineral production and to preclude the possibility that advanced or different processing, such as that performed by integrated producers, might serve as a basis for enhanced depletion. Thus, integrated operators were required to adopt the representative market price of the basic mineral product or, if there were none, to exclude the advanced processes from the computation.[58]

In 1943, Congress codified and adopted the essential features of the 1932 Treasury Regulations. It

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[55] Income Tax Act of 1913, Section IIB, c. 16, 38 Stat. 114, 166 (App. B, p. 1); Treasury Regulations 33 (1914 ed.), Art. 142 (App. B, pp. 1–2).

[56] Treasury Regulations 62 (1922 ed.), Art. 201(h) (App. B, p. 6).

[57] Treasury Regulations 74 (1929 ed.), Art. 221(i) (App. B, p. 64); Senate Debate, 1926, p. 3762 (App. B, p. 27); Joint Committee Report on Depletion, 1927, pp. 11–14 (App. B, pp. 32–34); see also, S. Rep. No. 52, 69th Cong., 1st Sess., pp. 17–18 (App. B, pp. 25–26); H. Conference Rep. No. 356, 69th Cong., 1st Sess., p. 31 (App. B, p. 29).

[58] Treasury Regulations 77, Art. 221(g) (App. B, pp. 135–137).

allowed only "ordinary treatment processes." In the case of certain minerals, it listed those processes. It excluded other processes, *e.g.*, smelting and refining, by name. Also, it refused to override the proportionate profits computation (provided for in 1940 Treasury Regulations) [59]—a computation which is designed solely for the situation where a taxpayer markets a different product and there is no representative market price for the basic mineral product.[60]

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[59] For a discussion of the proportionate profits computation, see *Alabama By-Products Corporation* v. *Patterson*, 258 F. 2d 892 (C.A. 5th), certiorari denied, 358 U.S. 930.

[60] Revenue Act of 1943, c. 63, 58 Stat. 21 (App. B, pp. 223–225); S. Rep. No. 627, 78th Cong., 1st Sess., pp. 23–24, 55 (App. B, pp. 210–211; 212–213); H. Conference Rep. No. 1079, 78th Cong., 2d Sess., pp. 20–21, 51 (App. B, pp. 219–220, 222).

For complaints leading up to passage of the statute, see the following: Silver Subcommittee Hearings, 1942, pp. 863–864, 1002–1010 (App. B, pp. 182–190); Silver Subcommittee Recommendations, p. 1039 (App. B, p. 192); Senate Hearings, 1943, pp. 527–529, 927 (App. B, pp. 201–207, 209).

For statements showing that the statute was a codification of the 1932 Treasury Regulations and indicating approval of the proportionate profits test contained in the 1940 Treasury Regulations, see the following: Senate Debate, 1942, p. 8033 (App. B, pp. 196–198); Senate Hearings, 1943, pp. 528, 927 (App. B, pp. 204, 209); House Hearings, 1947, pp. 1857–1858 (App. B, pp. 242–244); House Hearings, 1950, pp. 349, 355–356 (App. B, pp. 253, 255–257); Senate Hearings, 1950, pp. 771, 782 (App. B, pp. 275, 280); S. Rep. No. 2375, 81st Cong., 2d Sess., p. 52 (App. B, p. 282); House Hearings, 1951, pp. 1571–1573 (App. B, pp. 290–292); see, also, Dickinson, *Depletion—Gross Income—The Property*, 18–19 Mining Congress Journal (1932–1933), October 1932 issue, p. 9 (App. B, pp. 466–468); Dickinson, *Wheels of Government*, 28 Mining Congress Journal (1942), November 1942 issue, p. 50 (App. B, pp. 469–470); *Secretary's Report, American Mining Congress Reviews Its Activities in 1942*, 29.2 Mining Congress Journal, Mar.–Dec.

In the entire legislative history, extending for more than forty years, the only proposal that taxpayers be allowed to proceed on an individual, rather than an industry-wide, basis was a suggestion that certain types of metal miners be authorized to compute depletion on the basis of the crude, partially beneficiated or refined metals, depending on the actual method of disposition.[81] This proposal was rejected. At every stage of the history, it has been recognized that there must be a cut-off point, for each segment of the mining industry, which will separate the mining from the non-mining activities.[82]

1943), March 1943 issue, p. 21 (App. B, pp. 471–472); Dickinson, *Wheels of Government*, 29.2 Mining Congress Journal (Mar.–Dec. 1943), December 1943 issue, p. 54 (App. B, p. 472); Dickinson, *Wheels of Government*, 30 Mining Congress Journal (1944), January 1944 issue, p. 52 (App. B, pp. 474–476); Dickinson, *Wheels of Government*, 30 Mining Congress Journal (1944), February 1944 issue, pp. 115–116 (App. B, pp. 476–477, 478–479); Kent, *The New Idria Decision*, 30 Mining Congress Journal (1944), November 1944 issue, p. 21 (App. B, pp. 479–481); Dickinson, *Wheels of Government*, 30 Mining Congress Journal (1944), November 1944 issue, pp. 52–53 (App. B, pp. 482–483); Fernald, *Depletion and Related Problems under the Revenue Act of 1942*, 21 Taxes, The Tax Magazine, 141, 143 (1943) (App. B, 483–486).

[81] Shepherd Report, p. 71 (App. B, p. 87).

[82] Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, 1926, p. 55 (App. B, pp. 13–14); Joint Committee Report on Depletion, 1927, pp. 11, 13 (App. B, pp. 32, 33); Senate Hearings, 1928, p. 317 (App. B, p. 60); Joint Committee Report, 1930, Appendix XXXI (Shepherd Report), pp. 64, 68–71 (App. B, pp. 78, 82–87); Joint Committee Hearings, 1930, pp. 57, 110–111 (App. B, pp. 101–102, 105); House Hearings, 1932, pp. 331, 338–340, 345 (App. B, pp. 111, 114–116, 120); House Hearings, 1942, pp. 1199, 1202 (App. B, pp. 151–153); Silver Subcommittee Hearings, 1942, pp. 762–763, 860, 863–864, 1002, 1009–1010 (App. B, pp. 160–163,

3. The concept of "ordinary treatment processes," as the mining industry repeatedly represented and as Congress well understood, establishes an ascertainable cut-off point: Mining includes only such customary mineral treatment as is necessary in the particular branch of the mining industry in order to obtain, in marketable form, the basic mineral product.

Perhaps the most significant aspect of the legislative history, from the standpoint of the issues presented by this case, is that the mining industry itself has consistently taken the position before the Congress that it was seeking depletion on a basis which would not extend beyond the point where the mineral is made fit for commercial or industrial use.

So far as oil and gas depletion is concerned, it has always been assumed or acknowledged that the market or field price before conversion fixes the cut-off point. See *supra,* pp. 42–46. The Treasury Regulations have so provided. *Ibid.*

When the metal miners sought percentage depletion, the American Mining Congress advised that this method would provide an "approximation of the present worth * * * of ore in place,"[48] and that the includible mining processes would be those "cus-

175–176, 181–184, 186–190); Senate Hearings, 1942, p. 1322 (App. B, p. 193); S. Rep. No. 627, 78th Cong., 1st Sess., pp. 23–24 (App. B, pp. 210–211); H. Conference Rep. No. 1079, 78th Cong., 2d Sess., p. 50 (App. B, p. 222); Housing Hearing, 1947, p. 11 (App. B, p. 231); S. Rep. No. 831, 81st Cong., 1st Sess., p. 10 (App. B, p. 247); House Hearings, 1950, pp. 282, 379, 382, 414 (App. B, pp. 250, 257, 260); House Debate, 1950, p. 9282 (App. B, p. 266); H. Rep. No. 2319, 81st Cong., 1st Sess., p. 65 (App. B, p. 266); Senate Hearings, 1950, pp. 301–302, 771, 782 (App. B, pp. 270–272, 275, 279); S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 52–53 (App. B, p. 282); House Hearings, 1953, pp. 1986–1987 (App. B, p. 309).

[48] Senate Hearings, 1928, p. 308 (App. B, p. 57).

tomary within each division [of the metal mining industry] in disposing of ores, concentrates, or metals."[64] Congress observed that the integrated operator could readily compute depletion on the same basis ("net smelter return") as "the smaller operator who sells to a smelter."[65] The American Mining Congress has endorsed this position as correct.[66] As late as 1951, it stated that the test adopted was "the gross values of the ore produced" and that this test eliminated "discriminations as between individual producers of the same metal."[67]

Sulphur and coal were granted percentage depletion in 1932 along with the metal mines. The sulphur representative advised Congress that there would be no problem, as in the case of metals, in "allocating the proper portion of the income between that which was due to the mining operations simpliciter and that which was due to smelting, refining, transporting, etc."[68] Coal representatives never suggested that a more advanced product (*e.g.*, coke) could serve as a basis for depletion, although they pointed out that the coal industry was depressed and that many producers were not making a profit on their coal operations.[69] Moreover, the statute itself specifies the "ordinary treatment processes" for coal (cleaning, breaking, sizing and loading for shipment)—all of them processes

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[64] *Id.* at p. 317 (App. B, p. 60).

[65] Shepherd Report, p. 70 (App. B, p. 84).

[66] House Hearings, 1942, p. 1170 (App. B, p. 148).

[67] House Hearings, 1951, pp. 1572–1573 (App. B, p. 292).

[68] House Hearings, 1932, p. 340 (App. B, pp. 439–440).

[69] House Hearings, 1932, p. 345 (App. B, pp. 120–121). And see Senate Hearings, 1954, p. 1409 (App. B, p. 343).

applied at the mine to prepare coal for industrial or commercial use.

Our chronological review of the legislative history (Point II A, *supra*) discussed principally those minerals granted percentage depletion in the earlier years when the statutory provisions and the Treasury Regulations crystallized. However, in the 1940's and early 1950's, percentage depletion was extended to more than thirty additional minerals. All of these mining industries sought depletion on the same basis that it had been previously accorded. Testimony of their various representatives is set out at length in Appendix B, pp. 316–466. And see "Chart of Products in relation to which Various Branches of Mining Industry Sought Percentage Depletion" (App. B, p. 502). We stress that none of the industry representatives suggested that percentage depletion might be measured by reference to the sale of fabricated products. To the extent that it was suggested that depletion would include processing beyond extraction, it was on the basis that particular processes were ordinary and customary processes which were required to put the mineral in a state fit for industrial or commercial use.

For example:

The representative of the bentonite industry advised that "trucking bentonite to the processing plants where it must be dried, granulated, or ground, is a vital portion of the processing steps necessary to develop it to its 'first commercially marketable product'

stage; that is, in dried, ground, or granulated form and packed in bags." [70]

Processes such as washing, screening and grading, it was stated, are necessary to put sand and gravel in a marketable state." [71]

Percentage depletion on borax would be computed on the basis of the "crude or unrefined commercially marketable product derived from the application of various ordinary treatment processes." [72]

Crushing and grinding to consumer specification is essential in preparing talc for the market since it has no utility until it is finely ground." [73]

Vermiculite is sold "in its crude or concentrated form" to processors who "fabricate many different types of materials, all of which are sold through dealers." [74] "Since the depletion allowance relates only to miners, it is at once apparent that the taxes to be paid by processors and dealers would in no way be affected." [75]

The representative of the refractories industry—which consists of integrated producers who mine fire clay and certain other minerals and manufacture various products therefrom—did not request depletion measured by the value of finished products; [76] instead,

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[70] Senate Hearings, 1950, p. 448 (App. B, p. 323).

[71] *Id.* at p. 794 (App. B, p. 415).

[72] House Hearings, 1950, p. 2887 (App. B, p. 325).

[73] Senate Hearings, 1950, p. 791 (App. B, p. 446); House Hearings, 1953, pp. 2035–2037 (App. B, pp. 448–449).

[74] House Hearings, 1951, p. 1615 (App. B, p. 463).

[75] *Ibid.*

[76] See House Hearings, 1950, pp. 441–464 (App. B, pp. 335–341).

he submitted a list of some 67 manufacturers of refractory products who would be entitled to percentage depletion on the "value" of "raw materials used."[77]

A representative of the vitrified clay sewer pipe manufacturers of the United States also appeared before Congress to support a request that the depletion allowance on shale be raised from five per cent to fifteen per cent. He stated that the industry *manufactures* sewer pipe from fire clay and shale and that "present law provides percentage depletion rates for clays and shales *used* in the *manufacture* of sewer pipe." [Italics supplied.][78] He argued further that the "type of shales *usable* in the production of sewer pipe are at least as scarce and as difficult to locate as fire clays, for which a 15-percent depletion rate is provided." [Italics supplied.][79]

III

AS APPLIED TO THE FACTS OF THIS CASE, THE STATUTORY DEFINITION OF "MINING" REQUIRES THE CONCLUSION THAT TAXPAYER'S DEPLETION ALLOWANCE MUST BE COMPUTED WITH REFERENCE TO THE CRUDE MINERALS (RAW FIRE CLAY AND SHALE).

To this point, our argument has been directed to showing that the statutory definition of "mining" prescribes an ascertainable and uniform standard for determining the scope of mining in relation to each mineral, and that mining extends only so far as to include the minimum treatment or preparation which is necessary to make the mineral fit for commercial or industrial use. On this view, it is immaterial what

[77] *Id.* at pp. 455–456 (App. B, pp. 339–340).
[78] House Hearings, 1953, p. 2099 (App. B, pp. 416–417).
[79] *Ibid.*

end products a particular integrated miner-manufacturer elects to make or finds it profitable to make. Congress undertook to allow depletion in relation to mineral values consumed or exhausted in the process of mining, but it did not thereby undertake to guarantee miners a profit. Indeed, it was a representative of the American Mining Congress who stated, "The miner does not expect the Government to guarantee a profit to him." [80]

We turn now to an examination of the facts of this case and to the application of the principles which we urge.

A. Taxpayer mined fire clay and shale (in 60–40 proportions) from a mineral formation where shale underlay the fire clay. (R. 4, 24.)[81] The shale is also a clay, but one which contains some iron and is darker than fire clay when fired. (R. 201–204.) It is apparently indistinguishable from fire clay to the casual observer since at least one miner of both minerals could not tell them apart. (R. 174.) For depletion purposes, however, fire clay and shale must be considered separately. The two minerals are not always mined together and each is regarded as a separate branch of the mining industry. Moreover, the depletion rates for the two minerals are different, *i.e.*, fifteen per cent for fire clay and five per cent for shale.

So far as fire clay is concerned, the court below stated (R. 267, 270) that the record showed a sub-

[80] House Hearings, 1950, p. 351 (App. B, p. 253).

[81] Both are relatively inexpensive minerals for which percentage depletion was first allowed in 1951. Revenue Act of 1951, Section 319, c. 521, 65 Stat. 452 (App. B, p. 307).

stantial market in Indiana and that "large quantities" were sold in the taxable year.

Statistics of which this Court may take notice show further that there are substantial sales of fire clay on a national scale. In 1951, production of fire clay was over 11,800,000 tons, of which 3,150,000 tons were actually sold. The remainder was produced by integrated miner-manufacturers and used by them in their manufacturing establishments. Over 101,000 tons were exported, mostly to Canada. See Minerals Yearbook (1951), U.S. Bureau of Mines, Department of the Interior, pp. 293–295. Three years later, in 1954, over 4,400,000 tons were shipped by miners and, in addition, a little less than 4,000,000 tons were mined and used by integrated miner-manufacturers in establishments manufacturing clay, refractory and pottery products. 1954 Census of Mineral Industries, U.S. Department of Commerce, Bureau of the Census, pp. 14F–2 and 14F–5.[32]

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[32] We have noted above (*supra*, pp. 79–80) that the refractories industry in seeking depletion furnished a list of integrated manufacturers who used fire clay and stated that these manufacturers would be entitled to depletion on the "value" of the "raw materials used." Shortly after percentage depletion was extended to fire clay, *The Brick and Clay Record*, the leading trade journal in the clay industry, stated (issue of Jan. 1952, p. 25 (App. B, p. 487)) "that there is an established market and regular commerce in fire clay." Later, in 1953, a representative of the Refractories Institute suggested to the Ways and Means Committee that "ordinary treatment processes" should be deemed to include "crushing, grinding, screening and blending." House Hearings, 1953, p. 2072 (App. B, p. 342). This suggestion also falls far short of taxpayer's present contention.

The Court of Appeals also stated that the record showed significant Indiana sales of shale. (R. 267, 270). It noted in this connection that there were "two producers of shale in Indiana engaged in nonintegrated operations." (R. 270.)[23]

Official statistics also indicate national sales of shale, although in considerably less quantity than in the case of fire clay. In 1951, over 27,600,000 tons of "Miscellaneous Clays," including shale but excluding fire clay and other classified clays, were sold or used in the United States; of this, approximately 990,000 tons were actually sold. Minerals Yearbook (1951), U.S. Bureau of Mines, Department of the Interior, p. 300. Three years later, in 1954, there were net shipments of almost 30,000,000 tons of "common clay and shale" (excluding fire clay and other classified clays), including that produced and used by integrated operators having manufacturing establishments; over 3,800,000 tons of that amount were shipped by miners not having manufacturing establishments. 1954 Census of Mineral Industries, U.S. Department of Commerce, Bureau of the Census, pp. 14F–2, 14F–3, 14F–10.

The court below, having found substantial sales of both minerals, stated (R. 269) that the instant case was different from a prior group of cases lost by the Commissioner because in those cases the Government had "admitted that each taxpayer had no market, or

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[23] It also appears (R. 163–172) that a miner located in Kentucky, directly across the river from taxpayer, sold substantial quantities of both fire clay and shale to a sewer pipe manufacturer.

a market for only a negligible quantity, of the particular raw mineral involved."[84] It held against the Government, however, on the ground that this taxpayer, who had high mining and transportation costs, "could not sell [fire clay and shale] at a profit." (R. 271.)[85]

This ground, we submit, is untenable. We deal here with a tax benefit extended to miners to compensate them for the exhaustion of mineral assets. A mine does not become more valuable because the costs of operation are high or because its strategic market location is poor. An integrated operator, to be sure, may have many good economic reasons for conducting a mining operation far from the place where there is a profitable market for the mineral in question; his dominant, perhaps exclusive, interest is in the sale of *finished* products. For his *mineral* product, he sup-

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[84] *United States* v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 (C.A. 5th); *Townsend* v. *Hitchcock Corp.*, 232 F. 2d 444 (C.A. 4th); *United States* v. *Sapulpa Brick & Tile Co.*, 239 F. 2d 694 (C.A. 10th); *United States* v. *Merry Brothers Brick and Tile Co.*, 242 F. 2d 708 (C.A. 5th), certiorari denied, 355 U.S. 824; *Dragon Cement Co.* v. *United States*, 244 F. 2d 513 (C.A. 1st), certiorari denied, 355 U.S. 833.

[85] Although the court found that the minerals involved in this case were sold in raw form in substantial quantities, it made no mention of Section 114(b)(4)(B), subparagraph iii (App. A, *infra*, p. 94), which states that ordinary treatment processes shall include "in the case of * * * minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating and sintering to bring to shipping grade and form, and loading for shipment." Obviously, the processes sought by taxpayer here are not of the same order as those which are involved in bringing crude minerals to "shipping grade and form."

plies his own market. These considerations can hardly warrant the conclusion that he is entitled to include in his depletion base processes which a non-integrated miner would have no occasion to utilize. Congress, as we have stressed in Points I and II, undertook to treat miners as a class; to treat them uniformly—whether large or small, integrated or non-integrated; to restrict all of them to the ordinary treatment processes normally used by miners, *qua* miners; and to establish as a cut-off point the basic mineral product yielded by an application of the normal and necessary processes. Sales are significant for purposes of applying the statute not because an ability to sell profitably is relevant, but only because sales may provide conclusive proof that a mineral product has reached a state where it is fit for commercial or industrial use—proof, in other words, that the mineral has passed beyond the point where it can be said to be undergoing the ordinary processes of "mining."

If the words "commercially marketable mineral product" stood alone in the statute and one ignored the purpose, history and related language, there might be some basis for suggesting that "commercially marketable" means "marketable by the individual seller at a profit" (though, certainly, it would be at least equally arguable that "commercially marketable" means simply that there is a market to impose a profit *or* a loss). In all events, the words do not stand alone. The statutory authorization is that the miner may include "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral

product"—in other words, the product fit for sale or commercial use. See *New Idria Quicksilver Mining Co.* v. *Commissioner,* 144 F. 2d 918, 920 (C.A. 9th); cf. *Barber Asphalt Paving Co.* v. *Standard Asphalt & Rubber Co.,* 30 F. 2d 281, 284 (C.A. 7th)."[56]

Certainly, if there are miners who in fact do nothing more than extract and sell fire clay and shale, mining cannot be said to comprehend the fabrication which is involved in converting fire clay and shale into new finished products such as sewer pipe.[57] Could it be seriously contended, for example, if United States Steel and other principal steel makers and fabricators should, one day, obtain all the ore which they utilize from mines of which they have acquired ownership, that all of the processes used in making steel and steel products would become ordinary mineral treatment processes? As we stressed under Point I, mineral treatment or mineral dressing has a settled meaning in the mining industry; it refers to those processes which are necessary in order to separate the valuable constituent of the natural deposit from other matter. This, we repeat, was well understood by Congress. See *supra,* pp. 49–51, 54–55, 59–63, 67–68. Witness, for example, the following colloquy between the

[56] See, also, the definitions of "marketable" and "vendible" in Webster's New International Dictionary (2d ed., 1949).

[57] It should be noted that the district court did not find that the processes used by taxpayer were normally applied by mine owners. Significantly, the court states (Fdg. 10, R. 5): "All of the processes used and applied by plaintiff to the fire clay and shale which it mined and used, were processes normally applied by mine owners or operators *who are engaged in the manufacture of vitrified clay sewer pipe and related products.*" (Italics supplied.)

Chairman of the Ways and Means Committee and Mr. Henry B. Fernald, Chairman of the Tax Committee of the American Mining Congress: [88]

> The CHAIRMAN. I would like to ask you another question, Mr. Fernald.
>
> Do you think, in defining minerals, we should be careful *to separate the value added by manufacturing?*
>
> Mr. FERNALD. I think as we speak of manufacturing, as you and I are dealing with the use of that term, I can say *"Yes; I think we should."* However, there are very many processings of these minerals which I would never think of as being manufacturing, and I do not think you would, and yet which many do argue should be excluded because it is a manufacturing process.
>
> *The ordinary treatment processes which are normally applied to bring your minerals into a marketable condition* I do not think should be talked of as manufacturing costs.
>
> The CHAIRMAN. I agree with you on that, because, for instance, they have mines up in my State where the product cannot be sold until it is ground fine enough to go into the market. [Italics supplied.]

In short, the "ordinary treatment processes" which are includible in a taxpayer's depletion base are those which are necessary for the purpose of putting the mineral into its marketable state—otherwise stated, those processes which a non-integrated miner would have to use. Since, as the Court of Appeals found (R. 267–270), raw fire clay and shale are sold in

[88] House Hearings, 1953, pp. 1986–1987 (App. B, pp. 309–310).

substantial quantities, it is clear that those minerals require no processing beyond extraction. But even if there were any doubt on this point, there can be no sound basis for the court's conclusion that depletion may be taken on sewer pipe and other finished products.

B. We consider finally taxpayer's arguments that the *Merry Brothers* line of cases (see note 84, p. 84, *supra*) supports its contentions.

As the court below pointed out, in those cases the Government assumed or admitted that the taxpayers "had no market, or a market for only a negligible quantity, of the particular raw mineral involved." (R. 269.) On that basis, those cases held (though incorrectly, we believe) that "ordinary treatment processes" include manufacturing processes which are necessary to obtain a marketable product from the mineral. But it is plain that they did not go so far as to hold that the individual taxpayer's situation—his ability to market profitably—is the test. They rest simply on the proposition that it appeared that there was no market for the minerals involved.[89] Here, the court below found to the contrary, *i.e.*, that there was a substantial market for the minerals in question.

Taxpayer argues further that there is no real factual distinction to be drawn between the prior cases

[89] *United States* v. *Cherokee Brick & Tile Co.*, *supra*, 218 F. 2d at 425; *Townsend* v. *Hitchcock Corp.*, *supra*, 232 F. 2d 444; *United States* v. *Sapulpa Brick & Tile Co.*, *supra*, 239 F. 2d at 697; *United States* v. *Merry Brothers Brick & Tile Co.*, *supra*, 242 F. 2d at 709; *Dragon Cement Co.* v. *United States*, *supra*, 244 F. 2d at 517.

and this case because in those cases (or some of them) the Government could also have shown (or did show) that there were some sales.[90] Accordingly, taxpayer reasons, the sewer pipe industry should stand on the same footing as the brick industry. The short answer is that the courts in those cases made findings contrary to those which were made in this case and that it is therefore immaterial, from the standpoint of the legal significance of the holdings in those cases, that different findings might have been made if the pleadings and the proof had been different.[91]

We do agree with taxpayer, however, that the issue decided in this case and the issue decided in the *Merry Brothers* line of cases are closely related. As we advised this Court in our petition (pp. 13–14), if the legal position urged by the Government in the earlier cases "had been accepted by the courts, the issue now presented would not have large importance, for it would have been established that in all events manufacturing processes are not includible in gross income from mining."

It is also true that the issue presented in the *Merry Brothers* group of cases has continuing importance. There are apparently a number of branches

---

[90] We certainly would not dispute that the Government, in those cases, may have made concessions of fact which were unnecessary.

[91] Following the denial of certiorari in the *Merry Brothers* and *Dragon Cement* cases, *supra*, the Internal Revenue Service announced, on October 18, 1957, that it was "taking steps to dispose of pending litigation and claims involving brick and tile clay and cement rock, as required under these decisions, and to conform Treasury regulations and outstanding rulings accordingly." TIR–62, 1957 P–H, par. 76,726.

of the mining industry which, if they are not already fully integrated with manufacturing, may soon become so. Apart from other factors which may encourage integration, the decisions of the lower federal courts in relation to mineral depletion furnish a significant tax incentive.

In our view, it should make no difference whether a mining industry is non-integrated, partially integrated or fully integrated. Whatever the degree of integration, we believe that the term "ordinary treatment processes" refers to mining processes, and that the dependent clause "normally applied * * * to obtain the commercially marketable mineral product" indicates only that miners may claim processes beyond extraction to the extent that such processes are necessary to put the mineral in the condition where it is fit for commercial or industrial use. In the context of a tax allowance for "mining"—one designed to compensate for exhaustion of mineral values—there can be no sound basis for suggesting that if a branch of a mining industry becomes integrated with manufacturing, the depletion base, by that token, comes to comprehend the processes of fabrication.

As has been evident throughout our brief, our arguments as to the meaning of the statute and as to its history bear not only upon the correctness of the decision below; of necessity, they bear also upon the correctness of the approach adopted in the earlier cases decided in the courts of appeals. Inasmuch as this Court, in this case, will be estab-

lishing criteria to which the lower courts will hereafter look in interpreting the statutory definition of "mining," it is, we believe, appropriate that the Court consider the different (though related) approaches taken in the decided cases with a view to providing proper guidance for the future.

CONCLUSION

The judgment of the Court of Appeals should be reversed and the cause remanded so that taxpayer's "gross income from mining" may be determined in the light of the correct legal criteria.

Respectfully submitted.

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APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

* * * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * * *

(b) *Basis for depletion.*—

* * * * * *

(4) [as amended by Sec. 145 of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 319(a) of the Revenue Act of 1951, c. 521, 65 Stat. 452] *Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.*—

(A) *In general.*—The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine

wells, calcium chloride, magnesium chloride, and bromine, 5 per centum,

(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum,

(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone, and potash, 15 per centum, and

* * * * * *

of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

(B) [as added by Sec. 124(c) of the RevenueAct of 1943, c. 63, 58 Stat. 21, and amended by Sec. 207(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906, and Sec. 304(d) of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137] *Definition of Gross Income from Property.*— As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or oper-

ators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of section 450 and 453.

* * * * * *

(26 U.S.C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.23(m)–1 [as amended by T.D. 5413, 1944 Cum. Bull. 124, T.D. 5461, 1945 Cum. Bull. 284, and T.D. 6004, 1953–1 Cum. Bull. 45]. DEPLETION OF MINES, OIL AND GAS WELLS, OTHER NATURAL DEPOSITS, AND TIMBER: DEPRECIATION OF IMPROVEMENTS.—

* * * * *

(f) The term "gross income from the property," as used in sections 114(b)(3) and 114(b)(4)(A) and sections 29.23(m)–1 to 29.23(m)–28, inclusive, means the following:

* * * * *

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner

that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method. * * *

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In the Supreme Court of the United States

OCTOBER TERM, 1959

UNITED STATES, PETITIONER

v.

CENTRIFUGAL SEWER PIPE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

APPENDIX A TO BRIEF OF THE UNITED STATES

Part I: Pertinent Statutes, Legislative Materials and Treasury Regulations, 1913-1954.

Part II: Additional Legislative Materials: Excerpts From Hearings and Reports Indicating the Commercially Marketable Minerals to Which the Proponents of Legislation Had Reference in Seeking Percentage Depletion in Relation to Particular Minerals.

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1913

Income Tax Act of 1913

(c. 16, 38 Stat. 114, 166)

SECTION II

* * * * * *

B. * * *

That in computing net income for the purpose of the normal tax there shall be allowed as deductions: * * * sixth, a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business, *not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year* for which the computation is made, * * *. [Italics supplied.]

* * * * *

G. * * *

(b) Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association, or insurance company, received within the year from all sources, * * * and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made; * * *.

Treasury Regulations 33 (1914 ed.)

Art. 142. *The term "gross value at the mine,"* as used in paragraphs B and G of section 2 of the act of

October 3, 1913, prescribing a limit to the amount which may be deducted in the return of individuals and corporations as depreciation in the case of mines, *is held to mean the market value of ore, coal, crude oil, and gas at the mine or well, where such value is established by actual sales at the mine or well; and in case the market value of the product of the mine or well is established at some place other than at the mine or well, or on the basis of the bullion or metallic value of the ore, then the gross value at the mine is held to be the value of the ore, coal, oil or gas sold, or of the metal produced, less transportation, reduction, and smelting charges.* [Italics supplied.]

If the rate of 5 per cent per annum shall return to the corporation its capital investment prior to the exhaustion of the deposits, the rate on which the annual deduction for depletion of deposits is based must be lowered in accordance with the estimated number of years it will take to exhaust the estimated reserves.

In case the reserves shall be in excess of the estimates, no further deduction on account of depletion shall be made where the capital investment has been returned to the corporation.

1916

Revenue Act of 1916

(c. 463, 39 Stat. 756, 759)

SEC. 5. That in computing net income in the case of a citizen or resident of the United States—

(a) For the purpose of the tax there shall be allowed as deductions—

* * * * * *

Eighth. (a) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow,

but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof *not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year* for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided,* That when the allowances authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made. * * * [Italics supplied.]

1918

Revenue Act of 1918

(c. 18, 40 Stat. 1057, 1066)

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * * *

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a *reasonable allowance for depletion* and for depreciation of improvements, according to the peculiar conditions in each case, *based upon cost* including cost of development not otherwise deducted: *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is ma-

terially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the *discovery, or within thirty days thereafter;* such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; [Italics supplied.]

* * * * * *

1921

Revenue Act of 1921

(c. 136, 42 Stat. 227, 239)

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * * *

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided,* That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further,* That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter: *And provided further,* That

such depletion allowance based on discovery value *shall not exceed the net income,* computed without allowance for depletion, *from the property* upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; [Italics supplied.]

* * * * * *

[Section 234(a)(9) (42 Stat. 256), applying to corporations, is the same as Section 214(a)(10), applying to individuals.]

S. Rep. No. 275

(67th Cong., 1st Sess., pp. 14–15 (1939–1 Cum. Bull. (Part 2) 181))

[14] * * *

Section 214 allows substantially the same deductions in computing net income as are authorized under existing law, but adds the following provisions:

* * * * * *

[15] * * * (6) *in order to make it certain that the depletion deduction when based upon discovery value shall not be permitted to offset or cancel profits derived by the taxpayer from a separate and distinct line of business,* it is provided that the depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or the fair market value as of March 1, 1913; * * * [Italics supplied.]

Art. 201. Depletion of mines, oil and gas wells; depreciation of improvements.— * * *

* * * * * *

(h) Depletion allowance in case of discovery: The deduction for depletion in case of a discovery can not exceed the net income computed without allowance for depletion, from the property upon which the discovery is made, except where and to the extent that such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913. *Net income is* the *gross income from the sale of all mineral products and any other income incidental to the operation of the property for the production of the mineral products, less* operating expenses, including depreciation on equipment, and taxes, but excluding any allowance for depletion. If the mineral products are not sold as raw material but are manufactured or converted into a refined product, then the gross income shall be assumed to be equivalent to the market or field price of the raw material before conversion. Operating expenses, depreciation, and taxes on the property upon which the discovery is made, should be applied against the gross income from the same property on the basis of actual expenditures, but if the records for the year 1921 are in any case inadequate, allocation of such expenditures for that year may be made on the basis of the ratio of (1) the number of wells operated on the property on which the discovery is made to (2) the total number of wells operated in the operating division in which the discovery is included. [Italics supplied.]

(c. 234, 43 Stat. 253, 258, 269)

SEC. 204. * * *

(c) *The basis upon which depletion,* exhaustion, wear and tear, and obsolescence *are to be allowed* in respect of any property *shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except* that in the case of mines, oil and gas wells, discovered by the taxpayer after February 28, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the basis for depletion shall be the *fair market value of the property at the date of discovery or within thirty days thereafter;* but such depletion allowance based on discovery value shall *not exceed 50 per centum of the net income* (computed without allowance for depletion) *from the property* upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value. [Italics supplied.]

* * * * *

SEC. 214. (a) In computing net income there shall be allowed as deductions:

* * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In

the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

* * * * *

[Section 234(a)(8) (43 Stat. 283), applying to corporations, is same as Section 214(a)(9), applying to individuals.]

1926

[Provision for *percentage* depletion on *oil and gas* was first made by Section 204 of the Revenue Act of 1926, c. 27, 44 Stat. 9. The provision was added by the Senate Finance Committee and allowed a 25 percent rate of depletion. This was amended on the Senate floor to allow a 30 percent rate. In conference the rate was reduced to 27½ percent. Prior to the enactment of this statute hearings were held before the House Ways and Means Committee, the Senate Finance Committee and the Senate Select Committee on Investigation of the Bureau of Internal Revenue and each of these committees issued reports on the subject. There follows in chronological sequence material portions of these hearings and reports, congressional debates on the subject and the text of the statute together with the Treasury Regulations adopted thereunder.]

House Hearings, 1925

(Revenue Revision, 1925, Hearings Before the Committee on Ways and Means, House of Representatives)

[161] DISCOVERY AND DEPLETION

Statement of A. W. GREGG, Solicitor of Internal Revenue, TREASURY DEPARTMENT.

Mr. GREGG. Mr. Chairman and gentlemen of the committee, the next matter is the question of dis-

covery and depletion. Depletion is based upon the value of the property at the date of discovery in the case of oil wells, mines, etc. We discussed that in 1922. Since then the department has looked into several things which we think should be called to the attention of the committee. The discovery provision was first put into the statute to encourage the development of the natural resources of the country, primarily during the war, in 1918 for the first time. Under that provision, the discoverer, or the taxpayer who discovers an oil well, for example, can set up as the basis of depletion the value of the oil well at the date of discovery, and in making the deduction against the income from the operation of the oil well, the deduction is based upon the value at the date of discovery. I will give the history of that law: The deduction was unlimited under the 1918 act, and under the 1921 act it was limited to 100 per cent of the profits of the property upon which discovery was made. Under the act of 1924, you cut that to one-half and made it 50 per cent of the income from the property upon which discovery was made. That, it would seem, took care of the limitation of the deduction in the cases where the discovery value is properly given, but there are cases under the existing law where the taxpayer who is not really entitled to the discovery provision can get it.

* * * * *

[163] THE CHAIRMAN. Mr. Gregg, I might as well say at this point that if I had my way I would wipe out this discovery depletion entirely. I consider that it might have been justified in time of war, and that was the only justification given for it to begin with—for the purpose of inducing men to go ahead and make these discoveries. At the time we put that in, as I recollect it, it was practically admitted that in

normal times they would not be entitled to anything of that kind.

Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, 1926

(Investigation of the Bureau of Internal Revenue, S. Rep. No. 27, 69th Cong., 1st Sess. (commonly called the Couzens report, published in January 1926).)

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

January 7 (calendar day, January 12), 1926.—Ordered to be printed with illustrations.

Mr. Couzens, from the Select Committee on Investigation of the Bureau of Internal Revenue, submitted the following PARTIAL REPORT [pursuant to S. Res. 168, 68th Cong.].

Under Senate Resolution 168, Sixty-eighth Congress, First Session, adopted March 12, 1924, your special committee was appointed and directed to investigate the Bureau of Internal Revenue and report its findings together with recommendations for corrective legislation.

* * * * *

[2] SUMMARY OF FINDINGS

The findings of this committee upon the subjects covered by this report, may be briefly summarized as follows:

* * * * *

[3] *Discovery depletion*

Discovery depletion is an exemption from taxation upon realized increment in value; not enjoyed by other taxpayers. Upon a tax rate of 12½ per cent; this exemption to the oil industry alone amounts to approximately $37,500,000 annually, and during the

high-tax period it was correspondingly greater. But a minor part of this exemption is received by the wildcatter or prospector for whose benefit it was intended. The major portion of this exemption goes to the large oil-producing companies, which also deduct the prospecting and developing expense, intended to be offset by discovery depletion, from income as operating expense.

The regulations governing discovery depletion do not confine this exemption to the discovery of new deposits, but permit the blanketing of known pools of oil with discovery values, to be depleted, free of tax.

The statutory limitation of the value to be depleted, to that evident on the date of discovery or within 30 days thereafter, is ignored by the Commissioner of Internal Revenue, and indefinite periods of time are allowed, within which to fully develop values, to be deducted from taxable income as discovery depletion.

It is very clear that the purpose of the provision for discovery depletion was to stimulate prospecting for new deposits of mineral and oil, yet the allowance of discovery depletion is not confined to the taxpayers who discover new deposits of mineral or oil, nor to deposits discovered since March 1, 1913, but is allowed to taxpayers who develop discoveries made by others, and upon deposits known to exist prior to March 1, 1913.

Depletion of values determined by analytic appraisals

Analytic appraisals, which determine values to be depleted by discounting estimated expected profits, are too elastic and leave too much to the judgment of individual engineers to be suitable for taxation purposes. An amendment of the law is required to permit the substitution of a more suitable method. A substitute method is described herein.

There has been a growing tendency, on the part of

authorities in the Bureau of Internal Revenue superior to the engineering valuation sections, to set aside sound determinations of values to be depleted, and to substitute excessive values, based upon analytic appraisals, in which the value of manufacturing and sales profits are attributed to ores in the ground. This practice is forbidden by the regulations, but the regulations are being so generally ignored, in this respect, that an amendment to the law is considered necessary to prevent further discrimination.

* * * * *

[8] DEPLETION AND VALUATION OF NATURAL RESOURCES FOR DEPLETION AND INVESTED CAPITAL PURPOSES

* * * * *

Special examples of depletion

The enormous deductions either allowed or claimed in certain cases are astounding and bring out more clearly than any argument the need of proper regulation of this matter. The figures speak for themselves and will be given in three groups as in the case of our general statistics, inasmuch as they are taken from the same three sources.

* * * * *

[19] *Discovery depletion for relief of wildcatters (1865–66)*

An examination of the hearings before the Ways and Means Committee of the House and before the Finance Committee of the Senate, when the 1918 act was under consideration by these committees, shows that the purpose of the provision for discovery depletion was to stimulate wildcatting or prospecting for the oil and minerals then needed to carry on the war.

* * * * *

[20] It was to meet this situation that the discovery provision was put into the 1918 act.

The situation intended to be met by the discovery provision has so changed that every reason advanced for its enactment has disappeared.

* * * * *

Thus, neither the war necessity for an increased production, nor the high war tax, which it was claimed retarded production, can now be offered as justification for the continuance of this discriminating tax exemption.

Large operating companies, not small wildcatters, beneficiaries of discovery exemption

* * * * *

[23] *Discovery depletion not dependent upon discovery of deposit*

The language used in framing the discovery clause has permitted an administrative construction, which is far beyond, and at wide variance from, its obvious purpose.

* * * * *

[33] *Summary on discovery of profit*

* * * * *

[34] *It is therefore recommended that if discovery depletion is not entirely eliminated the law be so amended as to confine it to the discovery of a deposit.*

* * * * *

[45] *Depletion of intangible property*

* * * * *

[55] *Witherbee-Sherman and Co. (3054)*

This case illustrates in a most striking manner the effect of the inclusion of manufacturing profits in the value of ores in the ground.

The property involved is an iron mine located in the State of New York. The taxpayer operates a small smelter in which a very small part of the ore mined is converted into pig iron. The greater part of the ore is sold as ore and concentrates.

The metals valuation section valued this property as of March 1, 1913, for depletion purposes at the present value of the prospective profits to be derived from mining and selling ore and concentrates. On this basis a value of 38.9 cents per ton of ore was determined.

The Committee on Appeals and Review reversed the metals valuation section and allowed a value of $10,500,000 and a depletion unit of 62.97 cents per ton. This difference in depletion results in a difference in tax for 1917 and 1918 of $301,169.10. The same reserves and discount factor were used in both valuations. The only difference in the valuation is the expected profit per ton. *The $10,500,000 valuation is based upon the profits, which are estimated as procurable if the taxpayer builds a blast furnace near New York City and converts its ore and sells it as pig iron. Thus, this valuation attributes to the ores in the ground the prospective manufacturing profits estimated to be derivable from a blast furnace which does not exist and from a business in which the taxpayer is not even engaged. Exception has been taken to valuations of ore in the ground which included manufacturing and selling profits earned by taxpayers. In this case this element does not exist in the taxpayer's business but is imported into it for the sole purpose of inflating a value for depletion purposes*

Upon the theory applied in this case a valuation of a billion dollars could be justified by assuming that the taxpayer might go a [56] *few steps farther and*

convert his theoretical pig iron into theoretical watch springs. [Italics supplied.]

* * * * *

Intangible values not proper subject of depletion

* * * * *

[57] It is therefore recommended that the depletion provision of the income-tax law be so amended as to define the subject matter of depletion as the tangible physical deposit and to prohibit the use of any valuation based on prospective earnings in all cases where the profits capitalized are to a material extent due to the manufacturing or marketing ability of the taxpayer or to extrinsic causes other than the possession of the mineral itself.

* * * * *

[114] *Analytical appraisal method not suitable for tax purposes*

* * * * *

[115] That such appraisals, involving to the extent they do, the uncontrollable judgment of appraisal engineers, are a source of endless controversy between the Income Tax Unit and taxpayers, is not only a fact, but is not at all surprising.

[116] Any just method of determining depletion which does not involve the necessity of appraising the value of property by analytical appraisals will not only stop manifest gross discrimination but eliminate from the administration of the law one of the most fruitful sources of controversy, facilitate the determination of tax liability, and eliminate a great burden of expense to both the Government and the taxpayers.

* * * * *

Proposed substitute for analytic appraisal

A method of determining depletion and depreciation allowances in certain cases by discounting actual

profits annually as earned is proposed for the committee's consideration and will be fully described.

* * * * *

Senate Hearings, 1926

(Revenue Act of 1926, Hearings before the Committee on Finance, United States Senate, 69th Cong., 1st Sess. on H.R. 1.)

[147] REVENUE ACT OF 1926

Investigation of Bureau of Internal Revenue, Wednesday, January 13, 1926.

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to adjournment, at 10 o'clock a.m., in room 312, Senate Office Building, Senator Reed Smoot (chairman) presiding.

Present: Senators Smoot (chairman), McLean, Curtis, Reed of Pennsylvania, Ernst, Stanfield, Wadsworth, Shortridge, Simmons, Jones of New Mexico, Gerry, King, Harrison, Bayard, and George.

Present also: Senators Couzens, chairman of the Select Committee Investigating Bureau of Internal Revenue, and Mr. L. C. Manson, counsel to that special committee.

The CHAIRMAN. If the committee will come to order we will proceed. Mr. Manson, you desire now to take up the question of depletion, as I understand it.

Mr. MANSON. I do; yes, sir.

The CHAIRMAN. You may proceed.

Statement of L. C. MANSON, Esq., counsel for the Senate Select Committee Investigating Bureau of Internal Revenue

* * * * *

[148] Senator CURTIS. What section is that?

Mr. MANSON. That is section 214. The House has made some amendment to that section in the bill that is now before this committee. It is my judgment that the House amendment makes no material difference in the law. It cuts out the allowance of discovery values on proven areas unless the taxpayer enters into an agreement with the adjoining owner whereby he shares the cost of bringing in the discovered well.

* * * * *

[153] Mr. MANSON. * * *

Now, what I am leading up to in connection with this is this proposition: In the consideration of depletion of oil wells, [154] particularly, if the Congress should consider the allowance of a flat rate or a flat percentage of operating income——

Senator CURTIS. I will state here that I was going to offer an amendment providing for a percentage.

Mr. MANSON. What I want to bring out is that one argument that might be raised against a flat rate is that you would be allowing a depletion where it is not now allowed.

I desire to call your attention to the fact that if there is anybody that is not getting depletion now, it is because he has overlooked his opportunity, and I doubt it.

* * * * *

The CHAIRMAN. The simplest way, I suppose, to obviate that would be to have a flat tax on the operating income.

Senator CURTIS. On the gross income.

Mr. MANSON. The committee that I represent has not taken any position with respect to the uneconomic soundness of discovery depletion, and I do not care to enter into any further discussion of it, other than I have done for the purposes of calling attention to the way it operates.

Senator REED of Pennsylvania. That is only going half way. Can you not give us any recommendations about the way this thing should be handled?

Mr. MANSON. Well, I can when I get through. I would rather cover some other phases of it because I have more reasons for the recommendations that I would make than those I have given.

* * * * *

[158] Mr. MANSON. Without going into detail on the matter of valuation for depletion purposes, I want to say that *I believe that it is absolutely imperative that some method of determining depletion be figured out as a substitute for the present method of basing it upon valuations.* I do not think that any method could lead to more discrimination between taxpayers than the method which is now being pursued. We have not investigated a single oil valuation where two parties were interested in the same property where there was not a difference of at least 100 per cent in values placed upon the same property for depletion purposes for different interests. [Italics supplied.]

* * * * *

[177] Mr. MANSON. I think it was apparent from the testimony adduced before the committee that the valuation method which I concede to be the only practical method available for arriving at values for depletion purposes is entirely unsuited to the purposes of taxation.

The CHAIRMAN. Do you not think that is necessarily so?

Mr. MANSON. I do not believe it possible to arrive at a valuation of a mine or an oil well for purposes of taxation by any method that will insure justice between taxpayers. I do not think it can be done. I think, for instance, the valuation made by the

bureau of the copper properties varied as much as 300 per cent. I do not question the honesty nor the ability of the men who made those widely varying valuations. I do not believe it possible for any two engineers to value a mine or an oil well and arrive at a result that is even comparable without consulting and compromising on matters of judgment.

The elements of judgment involved in making valuations of this class are so great and there are so many of them that you could take small differences or judgment on each item and when multiplied together they will run into at least 300 or 400 per cent, run into differences which result in discriminations in the same industry which are so great that it makes it entirely unsuitable for purposes of taxation. *I believe that it is absolutely necessary that some other means be found for determining depletion than basing it upon value.* [Italics supplied.]

* * * * *

Senator REED of Pennsylvania. Now, what you are saying seems to me to go direct to the heart of the question that we are confronted with. As legislators we are interested in looking to the future and in establishing a rule that will work greater justice, and we are not here to try the rights or wrongs of what has passed. I want to ask you whether as a result of all your studies of this question you think a greater measure of justice in the long run could be established if we were to fix depletion allowance at an arbitrary percentage for all taxpayers on the selling value of their product?

Mr. MANSON. There is no doubt about it.

[178] Senator REED of Pennsylvania. You think that would work greater justice?

Mr. MANSON. It would work greater justice.

The CHAIRMAN. The operating income of the mine.

Mr. MANSON. What I want to say is this: That it was not my purpose in presenting these discrepancies in valuations here to impeach the ability nor the honesty of the men who made them. I presented all of these discrepancies for the purpose of illustrating the futility of trying to arrive at a just measure of depletion through appraisal methods.

* * * * *

[179] Senator REED of Pennsylvania. Let us assume that that point is settled and we are driven then to some arbitrary percentage method and consider only the copper industry which you are talking about. If we adopt an arbitrary percentage of the sale price of the product to allow that depletion, will not that do great injustice, because you cannot apply the same percentage to the Lake Superior project or the vertical veins at Butte or the Porphyry mines in Utah, because there are totally different geological questions there, and a percentage that might be proper for the Utah copper company would be all wrong for the Calument and the Hecla.

Mr. MANSON. I think if you will apply your percentage to annual earnings instead of the selling price of copper, you will overcome practically all of those inequalities.

Senator SIMMONS. Would you not overcome that, Senator Reed, by fixing an arbitary rate beyond which the reduction could not take place.

Senator REED of Pennsylvania. That still leaves us with the matter of valuation. You still would have to have this appraisal which Mr. Manson has so clearly shown is unreliable, and I agree with him.

The CHAIRMAN. It seems to me the operating income of these mines is the best possible basis for arriving at the amount of facts and do the least injustice.

* * * * *

[180] Senator REED of Pennsylvania. Mr. Manson has just suggested that you could give the mine owner an option either to take a depletion allowance of 20 per cent of his net income or a depletion allowance based on the actual cost to him, without any valuation at all.

Senator SHORTRIDGE. Senator Reed, your thought is applied to mine operations?

Senator REED of Pennsylvania. By "mines" I include all natural resources.

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[197] Statement of A. W. GREGG—Continued.

Mr. GREGG. On the matters that have been taken up to-day by Mr. Manson it seems to me that there are three points to discuss. * * *

On the matter of future legislation I recognize, as Mr. Manson does, the difficulty involved in these analytical appraisals. I think everyone realizes and appreciates that. It comes down in the last analysis to a matter of judgment. The law requires that the judgment be exercised by someone. In the past I think it has been exercised certainly honestly and intelligently in the decisions of the cases. If something can be done, however, to relieve the department of the necessity of making those valuations it will certainly be a great step in advance.

Senator WATSON. Well, what could be done?

Mr. GREGG. That is what I was coming to. *It has been suggested that depletion could be computed on a basis of a percentage of the net income from the operation of the property, computed without any allowance for depletion. That would relieve the department of a great many difficulties if it were possible.* [Italics supplied.]

The objections that occur to me to such a system are these: In the first place, in your solid minerals, you

would very clearly have a different rate for each mineral. The soundness of the proposal would depend on the rate used. I do not think that we have now sufficient data to arrive at a proper rate. I tried at Senator Jones's request to get the data, and I got some with reference to oil and gas, which is not satisfactory, but I was not able in the time I had to get any with reference to solid minerals, particularly of the different types of solid minerals on which depletion is allowed.

Even if you have sufficient data to arrive at a proper rate, looking at the industry as a whole, it should be realized that that rate even in a single industry which is proper to apply to one deposit in one part of the country will be absolutely improper as applied to another deposit even of the same material in another part of the country where the expense of mining, the expense of production, the grade of the ore, may vary materially. The whole question comes down, if you have sufficient data to get a proper rate, as to [198] how far Congress would be willing to go in the interest of simplicity as against the exact logic of the question.

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[199] Senator JONES of New Mexico. Now Mr. Gregg has said that he has been unable to arrive at a proper basis. What he means by a proper basis I do not quite understand. Or what particular facts he is seeking in order to get a proper basis I do not know. But clearly we are now supposed to give depletion based upon valuation of the property and various other things. Now it is true that any definite basis for deduction may be subject to criticism, but I think that we can reach a basis which is less subject to criticism than what we have in the law now.

Senator REED of Pennsylvania. Just because of that thought, and I confess that I have it as you have

expressed it, I would like to ask Mr. Gregg the same question that I asked Mr. Manson this morning. Suppose, Mr. Gregg, that you were the whole Congress of the United States, how would you handle this troublesome question of depletion?

Mr. GREGG. I do not know, Senator Reed. We have been thinking of it to my knowledge since 1922, trying to work out some plan. We thought then of the possibility of allowing arbitrarily a given percentage of the net profits from the operation of the mine or well as depletion. At that time we were all impressed with the inequities [200] of the situation, that that would result in grouping an entire industry at least under one head, giving each individual taxpayer within that group a rate of depletion based upon the average of the group, although it might bear no relation whatever to his own peculiar position. That objection still exists, of course. But if your rate gets low enough, in the interest of simplicity you can afford to be arbitrary and adopt a fixed rate admitting its arbitrariness and the inequalities which will result in individual cases from it.

* * * * *

[202] Senator REED of Pennsylvania. Now, Mr. Gregg, I brought that up merely to illustrate what seems to me an insuperable difficulty in the calculation of percentages. Having said what I repeated, this Midcontinent representative then went on to say that the lowest possible percentage which could be arbitrarily set for their depletion would be 25 per cent of their gross income from oil and that anything less than that would not begin to compensate them for the disappearing capital in an oil well.

The CHAIRMAN. Well, that would be too much for a mine. You would not want that in copper.

Senator REED of Pennsylvania. Suppose you fixed that with their curves and charts in view, and they seem to make a good argument, if you apply the same rule to bituminous-coal mining not a single company in the United States will show any profit.

The CHAIRMAN. That is why I say there is the difference between the oil and the mineral.

Senator REED of Pennsylvania. *So if we are going to ask an arbitrary percentage it has got to be a different percentage for different industries.* [Italics supplied.]

Senator JONES of New Mexico. *And should it not be based on net income rather than gross income?* [Italics supplied.]

Senator REED of Pennsylvania. *No.* [Italics supplied.]

* * * * *

[203] Senator JONES of New Mexico. I was going to suggest this, that in lieu of discovery depletion, and so on, that we allow a certain percentage of their net income to be deducted from it.

Mr. GREGG. That is what I understand Senator Reed was discussing.

Senator REED of Pennsylvania. That is tantamount to the same thing.

The CHAIRMAN. Well, the net income, there is something in that.

Senator REED of Pennsylvania. It comes down to the same thing in the end exactly, whether you allow an arbitrary percentage of deduction of net income, or whether you arbitrarily reduce the tax rate which is based on the net income. * * *

* * * * *

Senator SIMMONS. What is your proposition, Senator?

The CHAIRMAN. Well, there are two propositions. That you impose a tax of whatever percentage we

agree on the operating income derived from a mine, whether it be a well or whether it be copper or whatever it is. You take the operating income derived or the net income to that mine, and you then do not have to have anything to do with depletion. It is the production that counts. That is all there is to it. Now, the only trouble with that is between the oil and the metal mine. * * *

[204]

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Senator REED of Pennsylvania. I want to find out what the bureau has worked out in its studies. They have been trying to substitute something for it too. They are thinking along the lines that you and I are, Senator Jones, and I want to find out what position they have come to.

Mr. GREGG. That is what I said; we started on the percentage plan, and for the reasons which I stated to you, finally gave it up. Those reasons may not be insurmountable.

The CHAIRMAN. The percentage plan on what basis?

Mr. GREGG. Taxing the concerns on their net income without any deduction for depletion except an arbitrary percentage, 10, 20, 25 per cent of that net income computed without depletion.

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S. Rep. No. 52

(69th Cong., 1st Sess., pp. 17–18 (1939–1 Cum. Bull. (Part. 2) 332, 345–346)

[17]

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The administration of the discovery provision of existing law in the case of oil and gas wells has been very difficult because of the [18] discovery valuation that had to be made in the case of each discovered well.

In the interest of simplicity and certainty in administration your committee recommends that in the case of oil and gas wells the allowance for depletion shall be 25 per cent of the *gross income from the property* during the taxable year. The provision of existing law limiting this amount to an amount not in excess of 50 per cent of the net income of the taxpayer from the property is retained. [Italics supplied.]

Senate Debate, 1926

(67 Cong. Record (Part 4), 69th Cong., 1st Sess. (1926))

[3762] * * *

Mr. REED of Pennsylvania. I see the Senator's point. Will not the Senator let me explain what Congress has done and what the committee recommends now, and then we can go back to the more fundamental question which the Senator raises, as to whether either policy is right—that is, the past policy or the new one that we have recommended?

I hope I have explained to the Senate how this present method of calculating depletion in oil wells is really a combination of uncertainties. The factor of error that is possible in either of those elements is intensified by the fact that we are multiplying one uncertainty by another.

That leads to almost constant conflict between the oil-well operators and the bureau. There is hardly any important operator who does not have a lawsuit on every year's return, because he estimates that his depletion is, say, $1.25 a barrel, and the bureau sends its engineers down, and they make guesses different from those of the taxpayer, and they say to him, "No; your depletion is only 30 cents a barrel." While that does not sound very large when applied to an important producing area, it means a difference of millions of dollars to the Government and to the taxpayers.

So we are trying, by the Finance Committee amendment, *to get away from those uncertainties and to adopt a rule of thumb which will do approximate justice to both the Government and the taxpayers.* [Italic supplied.]

We find, then, that probably the best way to do it is to provide that an arbitrary percentage on the gross value of each year's yield be chalked off for depletion. We figure it on gross income instead of net income, because the net income from oil wells varies very greatly. When the first flush production comes the operating cost of the well is very low per barrel, but as the well trails down and finally comes to produce a small quantity of oil, the cost increases. Up in my State we have many wells working which average less than a quarter of a barrel of oil per day. Obviously, the operating cost of those wells is pretty high, and in many cases production gets down to the point where there is practically no net income, and yet the oil keeps flowing. There is a reduction of capital going on, and if we based the depletion on net income we would not always reflect it. [Italics supplied.]

* * * * *

[3763] Mr. REED of Pennsylvania. The Treasury Department selected at random 50 taxpayers engaged in the production of petroleum for the three-year period 1918, 1919, and 1920, and again for the three-year period 1921, 1922, and 1923. The result shows the percentage of depletion to gross income for those years, and I ask Senators to follow the figures carefully because some of them are pretty startling.

* * * * *

[3764] Mr. COUZENS. How many companies were involved in those figures?

Mr. REED of Pennsylvania. Fifty companies. I may say that these 50 companies are none of them

engaged in marketing refined products. If we took cases involving such companies, we would get into complications of their income from refining operations and that would obscure the lesson we can draw from the figures.

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[3767]

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Mr. HARRELD. * * *

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I think the proposal to change the method of calculating the discovery depletion charge is very commendable, is very proper, and is right. * * * All that a man is required to do is to report to the department his gross receipts from oil and take from it a depletion of 25 per cent. The only objection I can see to that is that I think it is not giving the producer of oil a sufficiently large percentage. In my judgment, it ought to be 35 per cent, and I may later offer an amendment to that effect.

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[3772]

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Mr. COUZENS. * * *

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Mr. President, much has been said about what this 25 per cent which is provided in the Finance Committee's amendment to this provision means.

After this amendment was first suggested in the Finance Committee by the senior Senator from Kansas [Mr. Curtis], the members of the investigating committee were asked, through Mr. Manson and myself, to ascertain what this would really mean, as far as they could. The conclusions reached, which are sub-

stantiated somewhat by these figures which I am now reading, were that a 25 per cent allowance on gross incomes meant in practice an allowance of 50 per cent on net incomes in all cases.

In other words, in some cases it might exceed the 50 per cent, but according to the statute the 50 per cent was the limit, and in no case could we find where it would be less than 50 per cent, so that in effect we might as well say that the discovery value allowed meant a reduction of 50 per cent of the net income in all cases. For example, we took 100 companies who reported in 1918. * * * .

H. Conference Rep. No. 356

(69th Cong., 1st Sess., pp. 31–32 (1939–1 Cum. Bull. (Part 2) 361))

[31]

* * * * *

The administration of the discovery provision of existing law in the case of oil and gas wells has been very difficult because of the discovery valuation that had to be made in the case of each discovered well. *In the interest of simplicity and certainty in administration* the Senate amendment provides that in the case of oil and gas wells the allowance for depletion shall be 30 per cent of the *gross income from the property* during the taxable year. The provision of existing law limiting this amount to an amount not in excess of 50 per cent of the net income of the taxpayer from the property is retained.

The House recedes with an amendment providing that the depletion deduction based upon gross income in the case of an oil and gas well shall be 27½ percent of that income instead of 30 percent, and in the case of mines the Senate amendment is changed to provide that discoveries shall include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the

taxpayer after February 28, 1913, if the vein or deposit thus discovered was not merely the [32] uninterrupted extension of a continuing commercial vein or deposit already known to exist and if the discovered minerals are of sufficient value and quantity that they could be separately mined and marketed at a profit. [Italics supplied.]

Revenue Act of 1926

(c. 27, 44 Stat. 9, 14)

SEC. 204. * * *

* * * * *

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that ——

(1) In the case of mines discovered by the taxpayer after February 28, 1913, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost. The depletion allowance based on discovery value provided in this paragraph shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value. Discoveries shall include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer after February

28, 1913, if the vein or deposit thus discovered was not merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and if the discovered minerals are of sufficient value and quantity that they could be separately mined and marketed at a profit.

(2) ***In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income*** of the taxpayer (computed without allowance for depletion) ***from the property,*** except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph. [Italics supplied.]

Treasury Regulations 69

(1926 ed.)

ART. 221. Depletion in the case of oil and gas wells—Under section 204(c)(2), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, "the property," as the term is used in section 204(c)(2) and this article, refers to the separate tracts or leases of the taxpayer.

(Preliminary Report—Depletion—Oil and Gas, Revenue Act of 1926, Report of the Joint Committee on Internal Revenue Taxation, Vol. 1—Part 2 (1927))

[11] TENTATIVE NATURE OF THE REPORT

* * * * *

There is still another reason for making this report preliminary rather than final, which is that, in the case of the very large oil companies, the returns themselves must be analyzed. The gross income of these large oil companies arises from transporting, refining, and marketing oil as well as from producing. For the purposes of our study, *the gross income from production alone must be determined.* The statistics of the bureau do not segregate this income, and recourse must be had to the returns. The bureau has been requested to furnish the returns for 38 large oil companies. It will take some [12] little time before these returns may be secured without inconvenience to the bureau. [Italics supplied.]

* * * * *

A. General Effect of 1926 Act

OIL AND GAS DEPLETION

1. 1926 and 1924 Acts Compared.

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The following definitions of certain words or phrases included in the above must be given in order to discuss the subject intelligently:

"From the property" is interpreted to mean from each individual tract or lease. In other words, the net or gross income must be computed not for all the prop-

erties of the taxpayer lumped together, but from each individual leasehold.

[13] "Gross income from the property" may be defined, therefore, for oil and gas properties, as *the gross receipts from the sale of oil and gas as it is delivered from the property less the royalties paid in cash, if any.* As it is not customary for operators to report oil royalties as a part of their receipts ordinarily, gross income will coincide with gross receipts. In the case of lessor interest, the royalty will represent the gross income from the property. *In the case of taxpayers who are operators, refiners, transporters, etc., the gross income from the property must be computed from the production and posted price of oil, as the gross receipts from a refined and transported product can not be used in determining the income as relating to an individual tract or lease.* [Italics supplied.]

"Net income from the property (computed without allowance for depletion)" may be defined as the gross income from the property as interpreted above, less the operating expenses, wages, repairs, taxes (except income taxes), losses not compensated by insurance, depreciation, and other legal deductions which can be specifically allocated to the individual tract or lease, and also less a reasonable amount of overhead, general and traveling expenses, etc., as may be properly prorated to this individual tract or lease.

* * * * *

2. Results of Change Made in 1926 Act.

The above comparison of the 1926 and 1924 revenue acts makes the following results self-evident as to the general effect of the 1926 act:

(a) It eliminates discovery depletion and the necessity for valuations as of date of discovery.

NOTE.—This result is beneficial to the bureau in that it reduces the valuation work. It is beneficial to the taxpayer in that he is relieved from supplying voluminous data on oil properties.

[14] (b) It retains the necessity for March 1, 1913, valuations.

NOTE.—This is not a serious matter as the great majority of such valuations have now been made.

(c) It retains the maximum limit for depletion at 50 per cent of the net income from the property.

(d) It retains the minimum limit for depletion on the basis of the cost or March 1, 1913, value of the property.

NOTE.—The same data must be kept for each property in regard to net income costs, and March 1, 1913, value under both the 1924 and 1925 acts; therefore there is no change in the administration of the features (c) and (d) described above.

(e) It allows an arbitrary 27½ per cent of the gross income from the property as depletion, if within the limits described in (c) and (d) above.

NOTE.—*As the gross income from each property is necessary in determining net income, there is no extra work of computing this provision.* [Italics supplied.]

On the whole, we may conclude, as far as the administration of the law is concerned, that the 1926 act requires less work and is simpler. As to the equity and effect on taxes of the provision, that will be discussed later.

* * * * *

1928

(Prior to the passage of the Revenue Act of 1928, c. 852, 45 Stat. 791, which rearranged the structure of

the revenue provisions, percentage depletion for metal mines was requested and an amendment allowing it was proposed on the House floor but was withdrawn for further study. More detailed Treasury Regulations relating to percentage depletion on oil and gas were also promulgated under the 1928 Act. The pertinent material is set forth below in chronological order.)

House Hearings, 1927–1928

(Revenue Revision, 1927–1928, Hearings before the Committee on Ways and Means, House of Representatives, Interim, 69th–70th Cong.)

[156] Brief submitted by Mr. PINKERTON on behalf of the Illinois Chamber of Commerce.

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[161] DEPLETION (Section 202(b)(2), (c)(1))

The same objection as is made in reference to the adjustment of depreciation is made to the principles underlying the adjustment for depletion for previous years at the time of a sale.

Moreover, the ascertaining of depletion rates has caused enormous work both to the Government and the taxpayers in ascertaining the 1913 values of mines. The present value method is most elaborate and complicated. Of course, the ascertainment of the 1913 values is now disposed of, but similar questions come up every time the value of a discovery is to be ascertained. *It is submitted that a rule should be devised for depletion of mines similar to that provided in the 1926 act for oil and gas wells.* The 1926 act provides that in the case of oil and gas wells the depletion deduction shall be 27½ per cent of the gross incomes from the property during the taxable year but not more than 50 per cent of the net income of the taxpayer from the property, and also provides that in no case shall the depletion allowance be less than it

would be if computed without the benefit of this 27½ per cent provision. This does away with all the complicated procedure of ascertaining discovery values and also of dealing with depletion allowed or allowable, as the taxpayer under this method would continue to get depletion as long as he was mining and selling ore. [Italics supplied.]

[505] Statement of J. F. CALLBREATH, Washington, D.C., Representing the American Mining Congress.

[Sec. 204 (c)]

Mr. CALLBREATH. My name is J. F. Callbreath, and I am secretary of the American Mining Congress.

The CHAIRMAN. Let me ask if you are willing to be limited to five minutes?

Mr. CALLBREATH. Yes; I am.

We appear at this time, gentlemen of the committee, in the hope that we may lend some assistance to you in the simplification of the depletion clause of the revenue act as applied to metal mines.

On August 4 the Commissioner of Internal Revenue sent out this invitation:

The Joint Congressional Committee on Internal Revenue Taxation has begun a study of the depletion question in order to determine whether or not a percentage of income basis *similar to that now in effect in the oil and gas industry can be applied to the other natural resource industries.* [Italics supplied.]

As a preliminary I want to make that statement.

In accordance with that invitation the metal mining industry was not able to get together in such a way as to authorize our office to appear before you as representing the industry until Tuesday of this week. At that meeting, a resolution was adopted asking the presentation of a plan which contemplates changes in subdivision (c) of section 204. Those changes appear

in caps upon the slips with which you have been furnished.

* * * * *

[506] The metal-mining industry in compliance with the request of the Commissioner of Internal Revenue has submitted data with respect to the operations of the various metal mines throughout the United States for the purpose of assisting the Treasury Department in supplying information requested by the joint committee on internal revenue taxation in connection with its study of the depletion question *in order to determine whether or not a percentage-of-income basis similar to that now in effect in the oil and gas industry can be applied to other natural resource industries.* [Italics supplied.]

It is believed that the division of investigation of the joint committee has completed its study of the subject as far as the metal-mining industry is concerned and is now ready to supply the information necessary to determine just how the proposed plan, if adopted, would affect public revenue and in general of the merit the proposed plan might possess from the standpoint of the Government as well as the taxpayer.

Certain positive advantages of the proposed plan may be briefly summarized as follows:

It provides a simple, definite method, easy of application, that permits the prompt and final determination of the tax liability.

It makes for simplification and substantial economy in administration not only in that it removes the difficulties attendant to discovery valuations but furnishes a method for computing the depletion deduction readily susceptible of audit in the field, a distinct aid to the decentralization policy now in force in the Internal Revenue Bureau.

It obviates the uncertainty inherent in any valuation plan due to the necessity for the use therein of numerous more or less arbitrary factors.

It removes the discrimination against the large number of smaller taxpayers who do not have the technical staffs or who feel unwarranted in going to the expense of engaging the professional services necessary to the establishment of discovery depletion under the present plan.

It removes the uncertainties resultant from the present methods when the unit depletion deduction requires adjustment due to unavoidable errors in the original estimate of ore reserves.

[507] Numerous conferences have been held by representatives of the metal-mining industry during the last few months while the commissioner has been gathering the information requested, in order that the industry might have a full understanding of what might be proposed on a percentage basis. This series of conferences culminated in a meeting held November 1, 1927, at which more than 75 per cent of the metal-mine production of the United States was represented, and at which time the plan herewith submitted was unanimously approved. *This plan has the united support of all branches of the metal-mining industry and its early adoption is urged particularly in the interests of numerous small operators in the several metal-mining States* who have been unable to take advantage of depletion allowances under the present law, on account of the great expense involved in the determination of valuation, and in particular the determination of discovery valuations under the present rulings and practices of the Bureau of Internal Revenue. [Italics supplied.]

It is not the desire at this time to take up the time of your committee by an extended oral presentation of this matter, but *it is requested that the American Mining Congress, on behalf of the metal-mining industry of the United States,* be granted 10 days within which time to prepare and file a brief in support of an amendment making the proposed plan effective by Congress at its coming session. [Italics supplied.]

The CHAIRMAN. Very well; you may file a brief and supply the members with copies.

* * * * * *

Mr. OLDFIELD. *Mr. Callbreath, are you trying to place the metal mining industry in the same positon as the oil industry?* [Italics supplied.]

Mr. CALLBREATH. *As nearly as may be; yes, sir.* [Italics supplied.]

* * * * * *

[508] Brief submitted by Mr. CALLBREATH for the American Mining Congress in behalf of the metal-mining industry of the United States.

PROPOSING AN AMENDMENT TO SECTION 204(c) OF THE REVENUE ACT OF 1926

Developments leading up to the submission of amendment proposed to section 204, subdivision (c).

To the Honorable Members of the Committee on Ways and Means of the House of Representatives:

The metal-mining industry, in compliance with the request of the Commissioner of Internal Revenue, has submitted data with respect to operations of the various metal mines in the United States, and those owned by American taxpayers in foreign countries. The purpose was to assist the Treasury Department in the compilation of information desired by the Joint Committee on Internal Revenue Taxation for use in

its study of the income tax law as relates to mine-depletion allowances. It has been understood that the purpose of the study on the part of the committee was to determine whether it is practicable to apply to the mining industry a percentage-of-income basis similar to that now in effect in the oil and gas industry.

It is believed that the division of investigation of the joint committee has completed its study of the subject as far as the metal-mining industry is concerned, and is now prepared to report on the merits of the proposed plan and to supply the information necessary to determine how it would, if adopted, affect the public revenue.

As a result of a concurrent study of the depletion question made by the metal-mining industry, the conclusion has been reached that the application of a percentage-of-income basis for the determination of the allowance for depletion in the case of metal mines if not only practicable but possesses certain important advantages from the standpoint of both the Government and the taxpayer.

It will be observed that the amendment proposed is a simple one which does not directly affect other provisions of the revenue act. Its adoption, therefore, will not make necessary any change in other portions of the act, nor will it in any way complicate other revisions which may be contemplated by Congress.

Briefly stated, the outstanding advantages of the amendment, which are discussed hereinafter, are, that without materially affecting the public revenue, it provides a simple, equitable, and definite method of computing the depletion allowance that permits of the prompt and final determination of the tax liability. It eliminates for the future the analytical appraisal of metal mines with attendant technical complexities. It means a great saving of expense to the Government

as well as the taxpayer. It removes all pretext for the objectionable recurring revaluations with which the industry has been confronted for years. It removes discrimination and gives to the smaller operator who can not now afford to spend the money necessary to establish proper value of his ore bodies and the corresponding depletion value of his unit of production, the reasonable allowance for depletion contemplated by the statute.

Provision for depletion as a deduction from income has been made in all of our income-tax laws and discovery depletion has been allowed specifically since 1918 and indirectly in the act of 1913. The deduction for depletion under the revenue act of 1916 was based upon either cost or the fair market value as of March 1, 1913. The revenue act of 1918 provided another basis, that of discovery value. With certain modifications there three bases have been carried down through the successive acts to date, the revenue act of 1926 at section 204(c) providing that the basis for the determination of the reasonable allowance for depletion authorized in section 234(a)(8) shall be cost, March 1, 1913, value, discovery value, and in the case of oil and gas wells, a fixed percentage of gross income.

The provisions of existing and earlier revenue acts employing a basic date method of valuation for the computation of depletion are and always have been based on sound economic principles, and for [509] lack of any experience as to means and results, it would have been unwise, if not impracticable, to have employed any other method. None the less, it always has been desirable to reach the same result by a shorter and simpler method. And now as a result of a practical experience of more than a decade in computing depletion on a valuation basis, it has become

possible to propose a definite rate of depletion for metal mines to govern in the future that will give assuredly a result fairly comparable to that obtained by valuation and without disturbing those valuations already agreed upon with the Treasury Department. Because of this experience, the rate proposed has a background of statistical authority.

The following proposed amendment is the result of numerous conferences attended by those interested in the metal-mining industry, and was unanimously approved by representatives of in excess of 75 per cent of the metal-mine production of the United States at a meeting held on November 1, 1927. It overcomes the numerous disadvantages of existing statute so far as metal mines are concerned.

Proposed amendment of section 204(c) (changes shown in italics):

"(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

"(1) In the case of mines discovered by the taxpayer after February 28, 1913, the basis for depletion shall be the fair market value of the property at the date of discovery or within 30 days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost. The depletion allowance based on discovery value provided in this paragraph shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be

if computed without reference to discovery value. Discoveries shall include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer after February 28, 1913, if the vein or deposit thus discovered was not merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and if the discovered minerals are of sufficient value and quantity that they could be separately mined and marketed at a profit. *This paragraph shall not apply to metal mines discovered after the effective date of this act.*

"(2) *In the case of metal mines the allowance for depletion shall be 15 per centum of the gross income from the property during the taxable year, such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowances for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.*

"(3) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

The figure of 15 per cent, here proposed, represents, to the best of the information available to the industry, an actual average of the depletion deductions which have been allowed by the Treasury Department under existing law during the past five years (1922 to 1926, inclusive), in each of the several branches of the metal-mining industry. From the information compiled by

the industry in response to questionnaires, it is believed that this figure will be substantiated by the studies of the division of investigation of the joint committee, which it is understood is prepared to report on the subject. The percentage depletion allowance here proposed is thus merely the equivalent of the actual allowances under previous revenue acts.

ADVANTAGES OF PROPOSED AMENDMENT

The percentage-of-income basis contained in the proposed amendment has the following distinct advantages: (1) Definite assurance of prompt and final settlement of tax liability; (2) simplification:
[510] (3) economy of administration; (4) the removal of present uncertainties; (5) the avoidance of discrimination.

(1) Definite Assurance of Prompt and Final Settlement of the Tax Liability.

The percentage method of determining the depletion allowance affords a direct and simple means of ascertaining the allowable deduction. The taxpayer may know definitely his tax liability when the return is filed, a distinct advantage over the existing system under which delay and uncertainty have been the rule rather than the exception.

* * * * *

Under the proposed amendment, both the Government and the taxpayer may readily compute the amount of tax due at the time the return is filed. The taxpayer may proceed with his financial commitments and the further development of his mines without the fear of large additional assessments. He would rather pay more tax, as he will in some cases under this system, and know that his obligation is fully and definitely discharged, than to pay less tax after a long delay.

The proposed amendment provides a simple, definite method, easy of application that permits the prompt and final determination of the tax liability.

(2) Simplification.

The phrase "gross income from the property" is used in existing statute, and, if applied in accordance with the trade practice of the different branches of the mining industry, has a definite, fixed meaning that is well understood in the industry. Fifteen per cent of the gross income from the property is accordingly an amount easily and definitely ascertainable. It affords in a simple, direct manner the amount of the allowable depletion deduction, and the prompt and final determination of net taxable income. [Italics supplied.]

* * * * *

Therefore, although the valuation basis for computing depletion allowances is essentially sound, it is desirable to provide a short method in the interests of simplification.

The proposed amendment bases the deduction upon a percentage of gross income from the property, a measure that is simplicity itself—15 per cent of gross income.

(3) Economy of Administration.

The preparation and audit of returns of income in the metal mining industry have proven most expensive to both Government and taxpayer.

* * * * *

[511] (4) The Removal of Present Uncertainties.

* * * * *

(5) The Avoidance of Discrimination.

A group of taxpayers discriminated against at present embraces a large number of small operators who make discoveries, but who are without organizations skilled in the procedure to be followed in proving

their discoveries. Such taxpayers are forced to employ expert assistance or else forego their rights under the law. Doubtless in many of these cases the expense involved in the employment of expert assistance would largely, if not entirely, offset the benefit derived from the establisment of discovery values. Under the percentage plan the small operator would in practice as well as in theory receive the same treatment as the large corporation, and without the expense and delays incident to the requirements of the Bureau of Internal Revenue in the administration of the present discovery provision.

The adoption of this plan would also remove the discrimination now existing against the mining industry as compared with the oil and gas industry.

GENERAL COMMENTS

It is quite generally understood that the percentage method of computing depletion has proven satisfactory to both Government and taxpayer in the Dominion of Canada.

From a careful survey of the data submitted, pursuant to requests of the Commissioner of Internal Revenue, to the Joint Committee on Internal Revenue Taxation, it is believed that the effect of the proposed amendment upon the Government revenue will not be adverse.

Since the percentage proposed is based upon an actual average of past allowances, it is believed that the total amount of tax paid by the industry will not be materially affected. Some reduction may be brought about through the granting of percentage depletion allowances to the many small operators who, because of the technicalities and difficulties in administration of the present discovery clause, have not been able to obtain their rights under the present law; but

while the number of such operators is large, their aggregate depletion allowance would be comparatively small in amount and it is believed that such allowance would not be greater than they are entitled to under present discovery provisions in the law.

[512] With respect to valuations prior to the date of the act, these certainly should be retained.

* * * * * *

It is understood from part 2 of volume 1, division of investigation, reports of the Joint Committee on Internal Revenue Taxation, that percentage depletion in the oil and gas industries has proven satisfactory to the Government and has afforded a deduction that very closely approximates that formerly allowed under the valuation method. The proposed amendment will, it is confidently believed, afford equally satisfactory results in the metal-mining industry.

It is the general belief of the metal-mining industry that the amendment herewith proposed presents a simple workable, businesslike method of meeting the situation, which is fair to the Government and to the taxpayer. It is respectfully urged that it be enacted into law at the forthcoming session of Congress.

Respectfully submitted.

THE AMERICAN MINING CONGRESS,
J. F. CALLBREATH, *Secretary,*
McKINLEY W. KRIEGH,
Chief, Tax Division.

House Debate, 1927

(69 Cong. Record (Part 1), 70th Cong., 1st Sess.)

* * * * * *

[599] The CHAIRMAN. The House is in Committee of the Whole House on the state of the Union for the further consideration of the bill H.R. 1, which the Clerk will report by title.

The Clerk read as follows:

A bill (H.R. 1) to reduce and equalize taxation, provide revenue, and for other purposes.

Mr. GREEN of Iowa. Mr. Chairman, under the order of the House the committee was permitted to return to page 79 for the purpose of considering the amendment offered by Mr. Arentz, and I believe he has the floor.

Mr. ARENTZ. Will the Clerk report the amendment?

The CHAIRMAN. Without objection, the Clerk will report the amendment.

The Clerk again reported the amendment, as follows:

Amendment offered by Mr. Arentz: On page 79, after line 24, add the following words: "This paragraph shall not apply to metal mines discovered after approval of this act," and add a new paragraph, as follows:

> In the case of metal mines the allowance for depletion shall be 15 per cent of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

Mr. ARENTZ. *Mr. Chairman, this amendment is introduced in the interest of simplification of the income tax.* [Italics supplied.]

One of the most technical and involved sections of the revenue bill is that one relating to depletion allowances.

No two men working independently of each other would reach, except by mere chance, the same conclusions regarding the rate of depletion to be applied to a particular ore or mineral deposit.

This is true in most cases where a technical physical examination is made of a natural resource developed but partially by underground workings or drill holes, irregular in shape, variable in mineral content, which in itself varies in price, to mention but a few of the factors entering into the determination of depletion allowance.

In the case of the United States against Ludey, Justice Brandeis had the following to say, as noted in Official Reports of the Supreme Court, under date of May 16, 1927:

* * * * * *

The amendment I have offered is in the interest of simplification. [Italics supplied.]

It will be observed that the amendment proposed is a simple one which does not directly affect other provisions of the revenue act. Its adoption, therefore, will not make necessary any change in other portions of the act.

The outstanding advantages of the amendment are that without materially affecting the public revenue it provides a *simple, equitable, and definite method of computing the depletion allowance* that permits of the prompt and final determination of tax liability. It eliminates for the future the analytical appraisal of metal mines with attendant technical complexities. It means a great saving of expense to the Government as well as the taxpayer. [Italics supplied.]

* * * * * *

[600] During this year, 1927, a questionnaire was sent to metal mining taxpayers throughout the country by the Commissioner of Internal Revenue with a letter stating that the joint committee had requested certain information regarding depletion allowances. In order to expedite the preparation of the information desired by the joint committee, the industry co-

operated almost 100 per cent and supplied all the information requested.

I have been informed by the Treasury Department that an investigation of the average depletion percentage allowed was found to be 16½ per cent on all returns allowed during the last four or five years.

Under the proposed amendment both the Government and the taxpayer may readily compute the amount of tax due at the time the return is filed. The taxpayer may proceed with his financial commitments and the further development of his mines without fear of large additional assessments. He would rather pay more tax, as he will in some cases under this system, and know that his obligation is fully and definitely discharged than to pay less tax after long delay.

The preparation and audit returns of income in the metal-mining industry have proven most expensive to both Government and taxpayer.

In the introduction of this amendment it is my desire to prevent this.

For the future discovery may be eliminated upon the adoption of an adequate percentage basis as proposed in this amendment. [Applause.]

* * * * * * *

Mr. COLTON. Is it not intended by the gentleman's amendment to give to the metal mines, as far as possible, a definite per cent for depletion the same as is now extended to oil companies? This would result in being helpful to the Government as well as to the mining industry, would it not?

* * * * * * *

Mr. ARENTZ. *I will say to the Chairman of the committee that it is not my intention to press this amendment at this time, but I would like to receive from the chairman of this great committee, the Committee on*

Ways and Means, a statement as to the extent of his desires to cooperate to the end that this elimination of difficulty of arriving at a return may be had by the introduction of amendments offered to it. [Italics supplied.]

Mr. GREEN of Iowa. Well, in answer to the inquiry of the gentleman, I think the gentleman has acted very fairly about it. He says he does not intend to press the adoption of the amendment at this time. The circumstances are these, as indicated by the remarks which the gentleman read from an article I wrote for the Saturday Evening Post. I think something ought to be done along this line, and it would undoubtedly, as the gentleman says, greatly simplify a matter that has caused the department a great deal of difficulty and trouble; and unfortunately in our discussions in the committee we took so much time with other matters that we got to this the last thing, and we did not have time properly to consider it. Not only that, but the experts never had time to be sure they knew what kind of an amendment ought to be prepared. Now, in pursuance of what the gentleman says, let the matter go over to the Senate and I am sure the mining interests will be taken care of over there, and by the time we get there we can tell what kind of a provision ought to be inserted; and if the Senate puts it in, as far as I am personally concerned, I will be very sympathetic with it.

* * * * *

Mr. ARENTZ. The idea with me is that the committee should not stand against this amendment simply because the experts might stand for something defining gross income, or something of that kind. When you talk of copper mines, for example, the definition is different from that when you talk of gold and silver mines and of lead-zinc mines. I hope you will not

hesitate in accepting this very important provision to clarify a subject which has been burdensome to taxpayer and Government alike for years and has resulted in much litigation, misunderstanding, and expense for the reasons I have stated. I thank the chairman for his courtesy and the sympathetic interest he has shown in this amendment.

Mr. GREEN of Iowa. We simply want time to go into this matter. I think at present the amendment ought to be voted down.

Mr. ARENTZ. Mr. Chairman, I withdraw my amendment.

* * * * *

Senate Hearings, 1928

(Revenue Act of 1928, Hearings before the Committee on Finance, United States Senate, 70th Cong., 1st Sess., on H.R. 1.)

[303]

* * * * *

The CHAIRMAN. I have also a brief on section 114–B, *in behalf of the metal-mining industry of the United States, submitted by the American Mining Congress,* as well as a memorandum in relation to the brief. They will all go into the record at this point. [Italics supplied.]

(The statements referred to are as follows:)

[304] Statement in behalf of the Metal Mining Industry of the United States.

March 23, 1928.

To the honorable chairman and members of the Committee on Finance in the Senate of the United States:

GENTLEMEN. At a hearing held on November 4, 1927, before the Committee on Ways and Means of the United States House of Representatives, on the pro-

posed revision of the revenue act of 1926, the American Mining Congress, representing the operators of metal mines of this country, proposed the following amendment to section 204(c) of the revenue act of 1926 to be incorporated in the proposed revenue bill for 1928:

* * * * *

[For text of amendment, see House Hearings, 1927–1928, *supra*, pp. 42–43.]

NOTE.—The above amendment in italics would be added to section 114, H.R. 1 on page 79, after line 24.

It will be noted that the language of the proposed new paragraph as to metal mines follows that of the provision relating to depletion of oil wells which has been said to be satisfactory.

HISTORY OF PROPOSAL

When the 1926 revenue bill was being considered in the conference committee of the House and Senate, on or about February 15, 1926, it was reported that a percentage-of-income basis for depletion of mines was being considered. As the bill was to be agreed upon by the conference committee within a period of four or five days from that time, representatives of the American Mining Congress advised members of the conference committee that it would be impossible for the industry, on such short notice, to prepare and consider the data necessary to an intelligent conclusion respecting any plan of this nature that might be proposed. It is understood that a report was made to the conference committee by a representative of the Treasury Department on or about [305] February 18, 1926, to the effect that it would be impracticable to provide in the 1926 bill for percentage depletion in the case of mines, as it would be impossible to determine within the time

available what percentage rate or rates should apply to different branches of the mining industry. Therefore no action was taken, but it was understood by those interested that the subject would be considered by the Joint Committee on Internal Revenue Taxation created by the revenue act of 1926.

Shortly after the organization of the joint committee in 1926, an announcement was issued from the office of that committee that depletion would be one of the first subjects taken up for study. During June, July, and August, 1927, a letter and questionnaire were sent to metal-mining taxpayers throughout the country by the Commissioner of Internal Revenue. The following are copies of letters received by the American Mining Congress showing the scope and purpose of the investigation of depletion allowances in the mining industry initiated by the Commissioner of Internal Revenue in order to comply with a request from the joint committee for information:

* * * * *

[306] In order to expedite the preparation by the bureau of the information desired by the joint committee, the metal-mining industry cooperated almost 100 per cent, and supplied all the information requested. It is understood the coal-mining industry cooperated in the same manner. In the meantime, believing that the matter was certain to be taken up in this Congress, and in order to render all possible assistance to the joint committee, and to other committees of Congress, and to arrive at a satisfactory solution of the question, numerous meetings were held in the metal-mining industry during August, September, October, November, and December, 1927, at which the subject was given thorough consideration by representatives of all branches of the metal-mining industry.

CONCLUSIONS OF THE METAL-MINING INDUSTRY

As a result of the study made by the metal-mining industry, the conclusion was reached that the application of a percentage-of-income basis for the determination of depletion allowances in the case of metal mines is practicable. From the best information available to the industry, it was found that the average of depletion deductions in the case of metal mines allowed by the Treasury Department under existing law during the five years, 1922 to 1926, inclusive, was in excess of 15 per cent of gross income. Therefore, representatives of the metal-mining industry decided that 15 per cent of gross income would be a fair basis for the future, provided it shall be enacted and applied without abrogating or disturbing any basis already established or allowable under existing and prior acts.

* * * * *

The provisions of existing and earlier revenue acts employing a basic date method of valuation for the computation of depletion are and always have been based on sound economic principles, and for lack of any experience as to means and results, it would have been unwise, if not impracticable, to have employed at the beginning any other method. None the less, it always has been desirable to reach the same result by a shorter and simpler method. And now as a result of a practical experience of more than a decade in computing depletion on a valuation basis, it has become possible to propose a definite rate of depletion for metal mines to govern in the future that will give assuredly a result fairly comparable to that obtained by valuation, and without disturbing those valuations already agreed upon with the Treasury Department. Because of this experience, the rate proposed has a background of statistical authority.

[307] INTERPRETATIONS OF PREVIOUS AND EXISTING DISCOVERY PROVISIONS OF THE REVENUE LAW

* * * * * *

The effect of the discovery provision, had it been applied to all minerals discovered after March 1, 1913, would have been to allow as a deduction from gross income of the mine taxpayer the present value in place as of date of discovery of such mineral or that capital value which was property. In other words, Congress, by enacting the discovery provisions, recognized a fundamental right of private property in this country, that whatever of value is inherent therein belongs to the owner thereof and is his capital.

* * * * * *

[308] CONFERENCES WITH THE TREASURY DEPARTMENT

Several conferences have been held with officials of the Treasury Department culminating in a general conference of February 1, 1928. Some questions had been raised by engineers of the department with respect to methods of arriving at the 15 per cent rate proposed. At this conference it was demonstrated that as to ores valued in the past by the department engineers, the rate of depletion in relation to gross income was in practically all cases in excess of 15 per cent.

It was contended by representatives of the mining industry that in determining what per cent of gross income should apply as a basis for the depletion allowance, only ores valued in the past should be taken into account. It is conceded by all who are familiar with the depletion question that if ore reserves could have been accurately determined in all cases, as they have been in some, the taxpayer would receive the depletion allowance on every unit produced until the mine is exhausted. Inasmuch as it has been impossible to ac-

curately estimate ore reserves in all cases, it is only fair that the statistical background we now have should be used in providing for a fair allowance representing the value of the mineral in place on a percentage of gross income basis.

The 15 per cent of gross income proposed merely means that 15 cents out of each dollar received from the sale of ore represents what has been determined in the past to be a conservative approximation of the present worth as of the basic date of ore in place. While this amount is somewhat lower than the average for ores valued in the past, the mining industry has agreed that it will be a satisfactory basis to apply to new ores developed or discovered in the future, and it eliminates the necessity for estimating tonnage to be valued.

These arguments are supported by the Supreme Court of the United States in the case of United States v. Ludey, decided May 16, 1927. * * *

[309] It is believed that officials of the Treasury Department are satisfied that the 15 per cent rate proposed is reasonable as a basis for depletion allowances in the case of all metals. As the result of these conferences with the Treasury, we are of the opinion that little question will be raised by the department concerning the matter of the rate. The real issue that will be presented to your honorable committee will be the question of how the percentage plan is to be applied, if adopted.

APPLICATION OF THE PERCENTAGE PLAN

* * * * *

[310] However, the mining industry is willing to accept the 15 per cent of gross-income basis for depletion allowances as a substitute for discovery value in the case of discoveries made after the approval of this act. The mining industry also contends that the per-

centage plan should be adapted to the situation in such a manner as to automatically correct underestimates of ore reserves; that is, where in prior valuations the estimates of ore reserves are clearly inadequate and the taxpayer has discovered and developed new tonnage, the percentage basis should apply to such tonnage irrespective of whether or not he would be entitled to discovery value on such tonnage under the existing rules and regulations of the department. In other words, the mining industry urges that the percentage plan be applied as the discovery provision should have been applied—to entitle the taxpayer to the "reasonable allowance for depletion" on the entire mineral contents of his mine.

FIFTEEN CENTS OUT OF EACH DOLLAR RECEIVED FROM THE SALE OF ORE BECOMES THE FIXED VALUATION OF ALL ORES NOT PREVIOUSLY VALUED

This precludes future errors in valuation such as underestimates of tonnage and errors of judgment in the application of the various factors involved in estimating the present worth of such tonnage as of a basic date, and avoids the enormous expense entailed by both taxpayer and Government in making valuations. We believe the statistical compilations made by the department and the Joint Committee on Internal Revenue Taxation with respect to ores valued in the past will show conclusively that *15 cents out of each dollar received from the sale of ore* is less than the average depletion allowance, not only in the case of each metal, but as to all metals averaged together. [Italics supplied.]

* * * * *

The percentage plan proposed unquestionably will be simple of administration, and will tend to equalize conditions as between different taxpayers in the metal-mining industry.

EFFECT UPON REVENUE

* * * * *

Under this percentage plan in all cases where the metal-mining taxpayer has an operating profit the Government will derive a tax, since, no matter how small the profit, at least 50 percent of the net income, before deducting depletion, will be subject to tax. This plan embodies a double limitation that is advantageous to the Government; first, in the case of high profits the maximum allowance is limited to 15 percent of gross income; second, in the case of low profits the maximum is 50 percent of net income. Thus, so long as mines make any operating profits the Government will derive a continuous revenue therefrom.

Respectfully submitted.

McKINLEY W. KRIEGH,
Chief Tax Division,
The American Mining Congress.

[311] ADDENDA

EXTRACTS FROM AMERICAN MINING CONGRESS BRIEF FILED WITH THE SENATE COMMITTEE ON FINANCE, 1926.

HISTORY OF THE DEPLETION PROVISIONS

* * * * *

[312–313] Let us turn from the legislative history of depletion to its economic base and justification.

DEPLETION BASED ON SOUND PRINCIPLES—THE MAINTENANCE OF A CAPITAL RESERVE BASED ON THE VALUE OF ORE OR MINERAL IN PLACE REPRESENTS A SOUND FINANCIAL PRINCIPLE, IS AN ECONOMIC NECESSITY TO THE CONTINUANCE OF THE INDUSTRY AND ITS RECOGNITION IN THE FEDERAL TAX LAWS IS FULLY JUSTIFIED.

* * * * *

[316] MEMORANDUM RELATIVE TO QUESTIONS RAISED BY DEPARTMENT OFFICIALS CONCERNING THE PROPOSED AMENDMENT TO THE REVENUE BILL TO PROVIDE FOR DEPLETION OF METAL MINES ON A PERCENTAGE-OF-INCOME BASIS.

* * * * * *

[317] 3. *Bases for application of the percentage rate.*—The Treasury may say that the proposed amendment is not sufficiently specific in its language to furnish a definite basis for determination of the amounts to which the 15 per cent and the 50 per cent are to be applied.

Answer: *The determination of 15 per cent as a fair average rate applicable to the different divisions of the metal mining industry took into account the various practices which were customary within each division in disposing of ores, concentrates, or metals.* The department seems to feel that the wording of the heretofore proposed amendment would not enable it to recognize these *variations as to the different divisions of the industry.* [Italics supplied.]

To meet this objection, the changed wording set forth in the revised form of the amendment submitted herewith is suggested. With this wording and the general power which the commissioner has under the law to prescribe regulations, it is believed all requirements are met. [Italics supplied.]

Attention is called to the fact that certain mining companies do not actually dispose of their products in the open market, but transfer them to related or affiliated companies on a cost-plus or other intercompany basis. Authority probably is necessary in the law to allow the commissioner properly to deal with such situations and the last sentence of the suggested revised amendment covers these situations. [Italics supplied.]

PROPOSED AMENDMENT AS NOW REVISED

Add to section 114, H.R. 1, page 79, after line 24, the following:

> This paragraph shall not apply to metal mines discovered after the approval of this act.

And add a new paragraph, as follows:

> (3) In the case of metal mines, if as to any ores or metals no depletion is allowable under the preceding paragraphs, or if the taxpayer shall waive as to any property for the taxable year and all subsequent years the right to any depletion allowance under the preceding paragraphs, the depletion allowance shall be 15 per centum of the total receipts from the sale or other disposition of the ores or metals from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income (computed without allowance for depletion) from the property. *Where products are transferred on an intercompany basis at a price greater or less than the market value, the total receipts and the net income subject to the percentage depletion reduction shall be constructively computed on the basis of current market value for the product so transferred.* [Italics supplied.]

* * * * *

[361–362] Statement of HARRY L. GANDY, executive secretary of the National Coal Association, Washington, D.C.

Mr. GANDY. Mr. Chairman and gentlemen of the committee, I am executive secretary of the National Coal Association, a nation-wide association of bituminous coal operators.

The suggestion has been made, in which the National Coal Association heartily concurs, that it may be the part of wisdom by this committee to confine

this bill to the matter of rates and noncontroversial questions.

* * * * *

Senator Watson's amendment offered to this bill would simply take the wording of section 204(c)(2), being the oil and gas optional standard rate for depletion, and strike out the words "oil and gas" and insert the words "coal mines" and change the rate from 27½ per cent of gross return to 6 per cent. It is barely possible that in the discussion of that amendment in the committee you may want to change it some.

The CHAIRMAN. There has already been suggested by the American Mining Congress an amendment to bring about the same result. But it was not 6 per cent, but 15 per cent.

Mr. GANDY. That applies to metal mines, and this is the same proposition applying to coal mines.

The CHAIRMAN. You may just put in your amendment at this time. We will take them all up at once.

Mr. GANDY. It is as follows:

> In the case of coal mines the allowance for depletion shall be 6 per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

That is all, Mr. Chairman.

* * * * *

Revenue Act of 1928

(c. 852, 45 Stat. 791, 799, 821)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction shall be equitably apportioned between the lessor and lessee. * * * [For percentage depletion in case of oil and gas wells, see Section 114(b)(3).]

(m) *Basis for depreciation and depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the same as is provided in section 113 for the purpose of determining the gain or loss upon the sale or other disposition of such property, except as provided in paragraphs (2) and (3) of this subsection.

(2) *Discovery value in case of mines.* * * *

(3) *Percentage depletion for oil and gas wells.*—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

ART. 221. *Depletion of mines, oil and gas wells; depreciation of improvements.*— * * *

* * * * *

When used in these articles (221–257) covering depletion and depreciation——

* * * * *

(i) "Depletion allowance based on the income from oil and gas wells": The deduction for depletion based on the income from oil and gas wells shall not exceed 50 per cent of the net income of the taxpayer, computed without allowance for depletion, from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to the income from the property. The phrase "net income of the taxpayer (computed without allowance for depletion)" means *the gross income from the sale of oil and gas less* the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, development expenses (if the taxpayer has elected to deduct development expenses), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. *If the oil and gas are not sold on the property but are manufactured or converted into a refined product or are transported from the property prior to sale, then the gross income shall be assumed to be equivalent to the market or field price of the oil and gas before conversion or transportation.* Depreciation, taxes, and such expenses as overhead (which can not be directly attributed to any particular property) shall be allocated on the basis of the ratio of the number of units produced from the property on which depletion is claimed to the total number of units produced from

the operating division in which the property is located. In cases where the taxpayer, in addition to producing oil and gas, engages in additional activities such as operating refineries and transportation lines, depreciation, taxes, and such expenses as overhead which can not be directly attributed to any specific activity, shall be allocated to the production of oil and gas on the basis of the ratio which the operating expenses and development expenses (if the taxpayer has elected to deduct development expenses) directly attributable to the production of oil and gas bear to the taxpayer's total operating expenses and development expenses. [Italics supplied.]

* * * * *

ART. 241. *Depletion in the case of oil and gas wells.*—Under section 114(b)(3), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. (See article 221 (i).) In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, "the property," as the term is used in section 114(b)(3) and this article, refers to the separate tracts or leases of the taxpayer.

1930

[The Joint Committee on Internal Revenue Taxation made a preliminary report on depletion in relation to *metal mines,* based upon surveys conducted by the Treasury Department, which included statistics, a proposal and brief submitted by the American Mining Congress, and a report (commonly called the Shepherd Report) which was made by a mining engineer of the

Joint Committee and which commented favorably upon the proposal of the American Mining Congress. Joint Committee hearings were also held after the Joint Committee's preliminary report.]

Joint Committee Report, 1930

(Preliminary Report on Depletion, Report to the Joint Committee on Internal Revenue Taxation from its staff (1930), Vol. 1, Part 8.)

LETTER OF SUBMITTAL

CONGRESS OF THE UNITED STATES
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

WASHINGTON, *September 17, 1929.*

Hon. WILLIS C. HAWLEY,
Chairman Joint Committee on Internal Revenue Taxation,
Washington, D.C.

MY DEAR CHAIRMAN. There is submitted herewith a preliminary report on depletion.

In my opinion, the report is sufficient to establish, first, that the distribution of depletion allowances among the taxpayers in the mining and quarrying industry is inequitable; second, that in certain cases the allowances are excessive; and third, that the present system lacks certainty and is expensive to both Government and taxpayer.

The present depletion allowances depend in each case almost entirely upon certain factors and conditions which would appear to have very little, if any, relationship to the computation of a fair annual income at the present time. In fact, in proposing two new plans for the determination of depletion, the point of view has been taken that it is most important to have taxpayers similarly situated pay the same rate of tax so that they may compete with each other without

disadvantage as far as Federal taxes are concerned. Under the present system some taxpayers pay high taxes and others are practically tax exempt.

The methods of percentage depletion proposed for consideration are not such a departure from the present system as would appear from a preliminary inspection. The analytic method of valuation now used in most important cases arrives at a value through the estimation of future expected profits. Depletion based on a percentage of the net income from the property merely uses actual figures instead of estimated figures.

While this report does not cover the subject completely, it is hoped that it will form a basis for discussion. Statistics which would appear helpful to those desiring to make a further study of this subject are included in the appendix. It is recommended that the report be published in order that it may be available for public examination and analysis.

Very respectfully.

L. H. PARKER, *Chief of Staff.*

[1] PRELIMINARY REPORT ON DEPLETION

FOREWORD

The valuation of all natural resources for depletion purposes has been required under every revenue act since 1916, with the exception of relatively few cases in which depletion is based on the cash actually paid for the property. The difficulties confronting the Bureau of Internal Revenue in the valuation of natural resources are almost insurmountable. Various causes may be assigned for this. In the first place, the methods of valuation adopted permit of wide discretion in individual judgment. The result is differ-

ences of opinion even with respect to the same properties. Many actual cases exist in which experienced engineers have differed in their reports on the same property by at least 400 per cent. In the second place, the date of valuation is so far removed from the date as of which the examination must be made that it is practically impossible to secure sufficient evidence to determine a correct valuation. In the third place, the turnover of personnel and the magnitude of the undertaking have added to the difficulties.

This report first considers the operation and effect of the depletion provisions of the existing law, with special reference to the resulting inequalities. A plan for percentage depletion which will eliminate, at least partially, the difficulties and inequities arising under the present system is next discussed. The subject is presented in as simple language as its technical nature will permit. The data necessary to support various statements and conclusions are in the appendix, together with other statistics which may be useful to those making further researches on this subject.

The primary purpose of the report is to form a basis for an intelligent discussion of the subject of depletion. It has been found impracticable to assemble sufficient data at this time to make a complete test of the soundness of the principles set forth. It is recommended that this preliminary report be printed for public examination and analysis so that taxpayers may have ample opportunity to analyze and apply these principles to their individual cases.

Synopsis

1. No Constitutional Limitation.

The Constitution does not require that the mine owner be given any allowance for depletion. The Supreme Court has held that this deduction is not one to

which he is entitled as a matter of right, but is a concession made by Congress in recognition of the equity in such cases.

[2] 2. Accounting Theory.

From an accounting standpoint, the proper basis for determining depletion is the cost of the property. This basis is not recommended because of the apparent hardships resulting from its application.

3. Statutory Provisions.

The existing law provides for five different bases for determining depletion, namely: Cost; March 1, 1913, value; discovery value; 27½ per cent of gross income; and 50 per cent of net income.

4. Methods of Valuation in Use by the Bureau.

The methods of valuation employed by the Bureau of Internal Revenue are as follows: (a) Comparative sales method, (b) prevailing royalty method, and (c) analytic appraisal method. As each of these methods is based upon different principles, it necessarily follows that the same results are not obtained.

5. Defects in the Present System.

(a) *Administrative.* — The administrative defects under the present system are (1) lack of uniformity in computing depletion, due to the exercise of individual judgment; (2) lapse of time between the basic date and the examination of the return; (3) inability to secure sufficient evidence to establish a correct valuation; and (4) excessive expense to both Government and taxpayer.

(b) *Instability of revenue.*—Under the present system, the depletion deduction is allowed before arriving at net income. In lean years the present depletion allowances practically wipe out the tax of this industry,

in spite of the fact that substantial dividends are paid. On the other hand, in prosperous years high taxes are collected. As a result, the revenue received from the industry as a whole is more unstable than in the case of the other industries. This appears undesirable from a practical revenue standpoint.

(c) *Inequitable results.*—There are many inequitable results in the present system. The different laws relating to depletion as applied to the different industries are not uniform. The oil and gas industry is allowed percentage depletion based upon gross income before the depletion deduction is computed. The effect of this allowance is to vary the deduction in proportion to the gross receipts from the sale of these products. Contrasted with this are the allowances based on a March 1, 1913, or a discovery value, in which cases the depletion varies with the quantity produced. Finally, in certain limiting cases, depletion is allowed on the basis of a percentage of the net income from the property. The valuation methods applied by both the Bureau of Internal Revenue and the taxpayer are not uniform and produce many inequalities between different industries. Valuations by the widely used analytic appraisal method depend largely on the peculiar conditions existing as of the basic date. These peculiar conditions appear to have little to do with an equitable tax on annual income. For example, taxpayers who make discoveries in periods of prosperity are allowed large deductions for depletion, whereas those who are so unfortunate as to make discoveries in years of depression are required throughout the life of the property to take a lower rate.

6. Methods Proposed for Consideration.

Several methods for computing depletion are proposed for consideration. They are as follows: (a) Fixed rate per unit method, [3] *(b) percentage of*

gross income method, and (c) depletion based on percentage of net income, consisting of plans (1) and (2). Both the fixed rate per unit method and the percentage of gross income method involve a wide departure from the allowance authorized by existing law and appear to produce inequities in the case of certain industries. Plan No. (1) of the percentage of net income method is based upon a percentage of net income from the property and is similar to the method adopted by Canada. Plan No. (2) is based upon a percentage of net income adjusted so as to allocate a reasonable amount of such net income to plant investment. This last plan when applied to concrete cases appears to produce more equitable results than the first plan. [Italics supplied.]

7. Advantages of Percentage of Net Income Method.

The percentage of net income method has many advantages. It will result in (a) elimination of discovery depletion, (b) simplification of administration, (c) partial elimination of March 1, 1913, valuations, (d) stability of revenue from this source, and (e) correction of inequities between different industries as well as between taxpayers in the same industry.

[6] Defects in the Present System.

(a) *Administrative difficulties.*—One of the principal administrative defects in the present system is the lack of uniformity and certainty in computing depletion. It is axiomatic that formulæ and methods involving different basic principles do not produce the same results. Each of the three methods of valuation in use by the Bureau of Internal Revenue involves basic principles not found in the other two methods. The application, therefore, of these methods must, of necessity, result in different values. * * *

[8] (c) *Inequitable results.*—One test of a satisfactory system of taxation is whether or not it imposes a uniform burden upon all industries. * * *

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[12] *The present system may result in gross inequities between individual taxpayers within the same branch of the mining industry.* * * * The two companies occupy adjoining properties, they are competitors in the open market, and apparently are operating under similar conditions. The unit rate of depletion, however, for the one is double that of the other. [Italics supplied.]

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Methods Proposed for Consideration.

Inasmuch as the present system of depletion has been shown to be neither simple in its application nor equitable in its results, it is desirable to find a substitute for this system. Several methods have been proposed and considered, each one of which will be discussed.

(a) Fixed rate per unit method.— * * *

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[13] (b) *Percentage of gross income method.*—The second method proposed for consideration is a form of percentage depletion and was proposed in a brief submitted to the Ways and Means Committee when it was considering the revenue bill of 1928. (See Exhibit XXX.) This proposal, showing the changes, is as follows:

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[The amendment is that which was proposed by the American Mining Congress, printed *supra*, pp. 42–43.]

[14] A report based on similar principles was submitted by Alex R. Shepherd, mining engineer for the

joint committee. This report is made a part of the appendix as Exhibit XXXI.

The method proposed by the American Mining Congress does not seem to meet the requirements as to uniformity of tax burden which have been discussed in this report. The method consists in applying a rate of 15 per cent to the gross income from the property in determining depletion. The percentage is arrived at from the average of the depletion allowed on cost, March 1, 1913, or discovery value. As this method is only effective in increasing the tax in the case of future discoveries, an apparent reduction in revenue to the Government from mining properties would follow its adoption. From the standpoint of simplicity, the method also appears to be undesirable. It still retains March 1, 1913, value and eliminates discovery value only with respect to the future. It also allows the metal-mining industry a still greater advantage than that received under the existing law. Under the existing law depletion is allowed only up to an amount equal to the cost, March 1, 1913, value, or discovery value, as the case may be, whereas the proposed method places no limit on the total depletion allowances except the practical limit set up by the exhaustion of the mine.

(c) *Depletion based on percentage of net income.*—A third method which possesses considerable merit is to allow depletion based upon net income from the property. Such a method appears practicable in two forms. Plan No. 1 consists of a deduction for depletion based upon a percentage of the net income from the property. Plan No. 2 consists in allowing depletion based upon the net income from the property after a reasonable amount of the net income has been allocated to the plant investment.

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[22] CONCLUDING REMARKS

This report shows that the present system for determining depletion is neither simple in its application nor equitable in its results. The present system is not only inequitable between taxpayers in the same branch of the mining and quarrying industry, but the distribution between the different branches is unjust. For example, bituminous coal mine operators have not received the relief given other mine operators. The coal industry has been profitable only in a few years and is now in a condition as depressed as agriculture. The present system results in taking away from the bituminous coal industry a large proportion of its profits in taxes in the infrequent year of prosperity. It appears, therefore, that a substitute method is desirable.

This report proposes several substitute methods for discussion. While the report indicates a preference for plan No. 2, a method of percentage depletion based on the net income from the property, it is hoped that the other methods will also receive careful analysis. In order to limit the scope of the discussion to the determination of a sound general method, certain subsidiary propositions like net losses, distribution of depletion between lessor and lessee, etc., are not considered. If a sound method can be devised, the related minor problems can readily be solved.

It is believed that if any plan of computing depletion is adopted based on a percentage of net income from the property, that both March 1, 1913, depletion and discovery depletion should be eliminated if substantial simplification is to result. It should be added in this connection that the argument has been advanced that it will be exceedingly difficult to determine the net income from the property. This argu-

ment does not appear to be supported by actual facts.

The existing law, namely, section 114(b)(2) of the revenue act of 1928, requires such a determination by providing that the allowance for discovery value in the case of mines *shall not exceed 50 per cent of the net income of the taxpayer from the property. Limitations of somewhat similar character are contained in the revenue acts of 1921, 1924, and 1926. During the many years that this requirement has been in the law, no complaint has been made that the net income* [p. 23] *from the property could not be determined. Furthermore, many operators of mining companies admit that the method of bookkeeping employed by mining companies will show the net income from this source without difficulty.* (Italics supplied.)

Sufficient data is not available for fully testing the operation and effect of the methods proposed. It is hoped that this report will stimulate such interest in the subject that the Bureau of Internal Revenue, as well as the taxpayers affected, will make a thorough test of these methods by applying them to actual conditions.

Respectfully submitted.

L. H. PARKER, *Chief of Staff.*

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[57] APPENDIX XXX

IN THE MATTER OF THE HEARING BEFORE THE COMMITTEE ON WAYS AND MEANS OF THE UNITED STATES HOUSE OF REPRESENTATIVES, SEVENTH CONGRESS, FIRST SESSION, ON THE PROPOSED REVISION OF THE REVENUE ACT OF 1926.

[Here follows the brief of the American Mining Congress, portions of which are printed *supra,* pp. 39–47.]

[63]

APPENDIX XXXI

Summary Report on Depletion of Metal Mines

[Commonly called the Shepherd Report]

Mr. L. H. Parker,
Chief Division of Investigation,
Joint Committee on Internal Revenue Taxation.

My Dear Mr. Parker. Several months have been spent in the study of this subject. It has resulted in definitely determining in dollars and cents the average depletion allowances per unit (pounds, tons, etc.,) for the minerals produced, to the taxpayers engaged in the metal mining industry.

Figures have also been assembled to show the relation between the average depletion allowances to gross and net income from the metal mining properties, on the basis of percentages, with the object of simplification in enacting future legislation on this subject.

The work has been accomplished in cooperation with officials of the Treasury Department and the taxpayers, who have furnished the necessary figures. The tabulations submitted represent approximately 75 per cent of the total production of the industries. It is thought that this percentage of production fully covers those taxpayers reporting net income to the Treasury Department.

From the information received, it appears that both the Bureau of Internal Revenue and the taxpayers are favorably inclined to the percentage basis for depletion allowances, in lieu of the existing discovery provisions, not because substantially greater or less depletion will be allowed but because of simplicity and certainty in tax determination.

It is believed that the substitution of the percentage basis, in lieu of the present discovery clause, will re-

sult in definite and prompt settlement of tax liability, in simplification, and in economy, both for the Treasury Department and the taxpayers and in elimination of uncertainty and discrimination which exists at present. This matter has been brought to the attention of the Committee on Ways and Means at its recent hearings by the American Mining Congress, representing 75 per cent of the metal-mining producers.

From long experience in the industry and knowledge of the actual functioning of the revenue legislation during the past seven years, I personally believe the proposed percentage basis for depletion allowances is sound and should not reduce the revenue derived by the Government from the metal-mining industries. It should, over a period of years, increase the revenue.

For brevity and simplification, the subjects have been segregated under the following headings:

Part 1. Brief review of depletion and its relation to this industry today.

Part 2. Summary and results in the study of percentage depletion.

Part 3. Recommendations as to a reasonable rate for percentage depletion.

Part 4. Effect of the proposed legislation on the present and future revenue to the Government.

[64] Part 5. Remarks on the amendment to section 204(c) as proposed in brief submitted by the American Mining Congress to the Committee on Ways and Means.

Part 6. Practical application of percentage depletion method to various classes of metal mines.

Detailed tabulations of the statistics are available in case they are desired.

Respectfully submitted.

ALEX. R. SHEPHERD,
Mining Engineer.

Part 1. Brief review on the subject of depletion and its relation to this industry today.

The depletion allowance as a deduction to the taxpayers is the return to him of that portion of the established value of his property which has been exhausted in any particular year.

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From the standpoint of Federal taxation for the future there is no valid reason for the continuation of the valuation of the taxpayer's individual developments of new ore reserves in the natural course of his mining operations. It should be of no interest to the Government from what hole in the ground the ores are from as long as it receives the right amount of tax from the taxpayers.

Less than one-tenth of the total number of taxpayers in the metal mining industries produce over 50 per cent of the total production and doubtless pay their proportion of the taxes to the Government. *These large corporations operate many properties of their own and are completely equipped with treatment plants from one end of the country to the other. They further purchase, refine, and market the greater part of the metals produced by the other operators.* [Italics supplied.]

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Part 2. Summary of the results of the study of percentage depletion.

Reports by the joint committee's staff and the Treasury Department, on the percentage basis for

depletion which has been in force for over a year in the case of oil and gas, show that it has functioned satisfactorily both from economical and administrative viewpoints and without loss of revenue to the Government.

A careful study of this method as applied to metal mines indicates that the same results will be attained in practice as in the case of oil and gas. [Italics supplied.]

The attached Table 1 is compiled from individual figures submitted by the metal-mining taxpayers and represents 75 per cent of the total American-owned production. It covers operations for the past five years (1922–1926), with gross sales (corresponding to gross income from the mining properties) of $2,437,921,266, with depletion allowances of $417,536,743 (which are based on cost, March 1, 1913, and discovery valuations).

The average depletion allowed for all metals is approximately 17 per cent of the gross sales for this period. This percentage expressed in cents per pound and per ton of metal on the basis of average depletion allowances is shown in Table 2.

In considering this table it should be borne in mind that these results are based on prices and expected profits which do not represent present-day conditions and what appeared to be a correct valuation in a particular case under certain conditions may be out of line with the facts to-day.

TABLE 1.—*Summary of the metal industries for a 5-year period (1922–1926), showing the gross sales (equivalent to the gross income from the property), and depletion allowed (on the basis of cost, March 1, 1913, and discovery valuations) for the different metals. This tabulation represents approximately 75 per cent of the total American-owned production*

	Gross receipts on basis of net smelter returns or equivalent	Depletion allowed	Depletion to net smelter returns or equivalent
			Percent
Lead-zinc ores [1]	$290,635,002	$50,026,529	17.21
Iron ores [2]	670,014,899	118,872,541	17.74
Coppers	1,318,794,543	226,930,118	17.21
Complex ores [3]	109,371,077	13,773,497	12.59
Gold and Silver	44,660,096	7,567,224	16.94
Miscellaneous metals	4,455,647	366,834	8.23
Total	2,437,921,266	417,536,743	17.127

[1] Includes Idaho and its silver values.
[2] Includes Lake Superior and Alabama ores.
[3] Mixed lead, zinc, copper, silver, and gold.

[66] TABLE 2.—*Summary of average depletion allowances (per pound, ton, etc.) to the various metals as established by past valuations (on the basis of cost, March 1, 1913, and discovery methods) and approximate percentage of production, with localities*

Metal	Location	Percent of total production	Average depletion unit allowed	Class of ores
Iron ores	Lake Superior ranges	75	56.31 cents per ton	Average all grades and interests.
Copper	United States, Canada, and South America.	75	2.606 cents per pound	Do.
Lead	Southeast Missouri	30	0.7512 cent per pound	Lead ore only.
Do	Utah, Colorado and Nevada.	28	0.808 cent per pound	Complex ores.[1]
Do	Idaho	20	1.112 cents per pound	Do.
Do	Joplin district	16	$4.29 per ton	Concentrates, zinc predominate.[2]
Zinc	do	60	do	Concentrates with lead.
Do	Eastern	15	0.3529 cent per ton	Zinc ore only.

[1] Complex ores. The practice in most cases has been to establish the depletion allowance on the predominating metal, though there are other commercial recoverable metals included, such as zinc, silver, and, in some cases, gold and copper, arsenic, etc. The greater portion of the complex ores is sold direct to smelters and refineries either in the crude or partially refined form.

[2] This rate includes some rock tonnages. On the basis of a 60 percent zinc-lead concentrate the depletion allowed approximates $7.28 per ton; this is equivalent to six-tenths of 1 cent per pound of the combined lead and zinc metals.

No attempt has been made to ascertain separate average depletion units for gold and silver, as the major production is derived from the copper, lead, and zinc ores. However, the individual properties show approximately the same percentage to gross sales.

Part 3. Recommendations as to a reasonable rate for percentage depletion.

Table 1 shows that the metal-mining industry has received in depletion allowances an average deduction equivalent to about 17 per cent of the gross sales.

From the study of this subject it is believed that 15 per cent of the gross sales value with a 50 per cent limitation to net income, would be a reasonable rate to allow the metal-mining industry for the future. This reduction by 2 per cent of the actual figures shown in the summary is thought advisable to offset the continuing effect of the percentage depletion method. [Italics supplied.]

The 15 per cent depletion allowance on gross sales is equivalent to a theoretical deduction of 30 per cent on net income. In actual operations the 30 per cent on net may vary 15 per cent above or below this figure, depending on the profits made by the particular operation.

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Part 4. Effect of the proposed legislation on the present and future revenue to the Government

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[68]. Part 5. Remarks of the amendment to section 204(c) as proposed by the American Mining Congress on behalf of the metal industry to the Committee on Ways and Means

It will be noted that the wording of the proposed amendment, section 204(c)(2) is identical with the 1926 act of oil and gas. If it functioned in a similar manner all past allowed and claimed discovery depletion would automatically be superceded by the percentage basis, with the enactment of the amendment.

However, on page 9, paragraph 5, it is stated "With respect to discoveries prior to date of the act, it is strongly felt that these should be retained." The reasons given follow in the brief.

The question as to the advisability of attempting to keep the discovery depletion allowances (allowed and claimed) for the future—is one upon which there seems to be a division of opinion among the taxpayers.

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In whatever manner it is decided to handle the matter, there are other questions which will need consideration and final determination.

It will be necessary to define what is meant by gross income from the property and to definitely indicate the point in accounting at which it is to be determined as well as other details. This can be done, either in the act, or interpreted in the regulations. [Italics supplied.]

The consensus of opinion seems to be that the act should be written as simply as possible (as in the case of oil and gas) and the necessary definitions should be written into the regulations. [Italics supplied.]

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Part 6. Practical application of percentage depletion method to various classes of metal mines.

In order that a better understanding may be had of the proposed plans for the determination of gross income from the property and net income, in reference to percentage depletion, a brief summary is given for each of the metals, showing the various metallurgical processes or steps through which they must pass from the crude mine ore to the marketable product.

The process of preparing copper, lead, zinc, silver, and gold for sale to a manufacturer usually entails five distinct operations.

1. Mining, or getting the metal-bearing rock out of the ground.

2. Concentrating, or separating the profitable portions of the run-of-the-mine rock from the unprofitable. This involves crushing, fine grinding, concentrating tables and in most cases to-day selective flotation of the remaining portion of the minerals in the rock. By these processes from 75 to 95 per cent of the valuable minerals are recovered from the crude ore and the bulk reduced from 10 to 30 tons of crude ore to 1 of concentrates. Five to twenty-five per cent of the metal remains in the crude ore and is lost or goes into the waste piles.

3. Smelting, or isolating the metallic constituents as impure bullion from the remainder as slag after melting the whole of the concentrate with appropriate fluxes in a suitable furnace.

4. Refining or separating the metals from each other.

5. Marketing the refined products.

There is a wide diversity in methods, practices, and application of these five operations depending on locality, metals, and expediency in many cases.

However, for the present purposes it is not such a difficult matter to group the methods and practices and to demonstrate the point at which the sales of the products take place. Generally speaking, all the metals are sold by the producers on the basis of the market quotation of the refined product. [Italics supplied.]

In the case of the smaller operator, the product in most all cases is sold in the crude or semirefined (concentrate) state to smelter under contract or otherwise. [Italics supplied.]

The smelting after weighing and sampling the ore or concentrate renders the seller a statement setting forth:

The gross metallic contents of the shipment.

Net metallic contents and market quotation.

Deduction for all costs, of freight, treatment, penalties, etc.

[70] *Net value in dollars and cents to seller (known as the net smelter returns) and a check in favor of seller for the product sold. Each ore shipment to the smelter is generally liquidated in the above manner.* [Italics supplied.]

Therefore, in the case of 90 per cent (in numbers) of the taxpayers their gross income from the property is the smelter return settlement, less royalty due lessors. [Italics supplied.]

On the taxpayer's returns this figure forms the base for his (1) gross sales from trading, etc. His cost for fire treatment, losses in refining, freights and marketing have already been deducted. The remaining costs of mining, concentrating, overhead, interests, etc., are further to be deducted along the line. In actual practice, there appears to be some variation in reporting these credits and deductions but undoubtedly the net results are the same in most cases. [Italics supplied.]

In the case of the large mine operators with complete plants for concentrating, smelting, refining, and marketing, the practice in accounting from a tax-reporting standpoint is more or less the same as the smaller operator who sells to a smelter or its agent. [Italics supplied.]

Most of them do custom work and therefore must keep accounts of the cost of refining ores from their own properties in a similar manner as is done with with purchases ores. *Therefore, the net smelter re-*

turn basis can apply equally to their own operations. [Italics supplied.]

They will receive a slight advantage over the smaller operator in that he pays whatever profits the larger operator charges for treating and marketing the product and may get slightly less recovery than is actually made. However, this is the case in all business transactions, and from a taxation standpoint we can only compute the tax on what a taxpayer actually receives for the products sold. [Italics supplied.]

A thorough survey of the situation shows that the metals are sold on different bases in the refined, semi-refined, and crude states. In order to clarify the matter, a brief review is herewith set forth for the different metals.

Copper.—The greater part of this metal is marketed in New York on the basis of the refined metal. The total mine production is around 2,500,000,000 pounds annually. Charts are available to show the sources and distribution of this metal which total approximately one-half of the value of all the metals produced.

There are about 40 leading producers of copper to-day. Of these, 12 companies produce 75 per cent of the entire production and of these 12, three corporations control 75 per cent of the output. In addition, they refine and market probably over 90 per cent of the total production of the United States, Canada and South America. It is, therefore, evident that their sales value must be computed on the basis of the refined metals, which also includes both gold and silver as byproducts.

Lead and zinc.—The total mine production of lead to-day is around 2,000,000,000 pounds of refined metal annually. The total mine production of zinc to-day

is around one and one-third billions pounds of refined metal.

Probably in over 70 per cent of this production the two metals are mined together (from complex ores), also with silver and a small amount of copper and gold in some localities, as by-products.

[71] Practically all of the metals require fire treatment and *are sold in the semirefined on concentrate basis to smelters or refineries,* and while practices vary in localities the basis of receipts for the product sold correspond to the "net smelter settlement." *This means that "gross income from the property" is definitely fixed at the mine or mill, as in the case of smelter settlement. While there are a few exceptions to this general state, there should be no difficulty in establishing the same mine or mill basis for them* [Italics supplied.]

Gold and silver.—Approximately two-thirds of the total production of these metals is produced as a by-product, in copper, lead, and zinc mining. The remaining third is produced by mines which either produce both metals together or singly. *In a few instances, pure bullion is produced at the property, in most instances the refining is done by smelters. In either case it is evident that their gross income from the property is logically based on the product sold or refined metal.* [Italics supplied.]

Iron ores.—Eighty per cent of the iron ore is produced from the Lake Superior regions. This ore has an established market price at lower Lake ports. For State taxation purposes, all accounts reflect the value of the ores f.o.b. cars at mine or property. *Therefore, it is logical to peg "gross income from the property" f.o.b. cars at mine. The same basis is logical and practical in all other iron mines throughout the country.* [Italics supplied.]

Finally, it should be stated that this subject has had careful consideration for several months. Its details and difficulties have been thoroughly discussed with the taxpayers in the various industries and the bases established are thoroughly understood. All nonferrous metal sales are based on or reflect the established New York quotations.

While the final drafting and proper phraseology of the definitions in the regulations must be made by those legally appointed and qualified for the work, the *following tentative suggestion is proposed* by the engineering section of the bureau, in order to cover the details involved. [Italics supplied.]

For the purpose of this subdivision "the gross income from the property" shall be the competitive market receipts, or its equivalent, received from the sale of the crude, partially beneficiated or refined *gold, silver, or copper, the product actually disposed of by the taxpayers to govern the method of computation of receipts in all cases,* and *in the case of all other metals, coal and oil and gas, the competitive market receipts, or its equivalent, received from the sale of the crude products, or concentrates on an f.o.b. mine, mill, or well basis.* [Italics supplied.]

The "net income of the taxpayer (computed without allowance for depletion) from the property" shall be determined by deducting all allowable expenses except depletion from "the gross income from the property" as defined above. In the case of leases the "lessor's income shall constitute the royalties and the lessee-operator's income shall constitute the gross receipts less the royalties."

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(Depletion of Mines, Hearings before the Joint Committee on Internal Revenue Taxation, 71st Cong., 3d Sess.)

[2] Statement of L. C. GRATON, Cambridge, Mass., on behalf of various interested parties:

Mr. GRATON. My name is L. C. Graton. I reside at Cambridge, Mass. I am a mining geologist by profession.

The CHAIRMAN. Without objection, the witnesses will be allowed to complete their statements in a connected order and then members of the committee will ask questions at the conclusion of the statements. Whom do you represent, Mr. Graton?

Mr. GRATON. I speak for a group of taxpayers from various parts of the country and for one taxpayer, a domestic corporation, who operates outside of the country, the Cerro de Pasco Copper Corporation.

The CHAIRMAN. Proceed with your statement.

Mr. GRATON. What I have to say Mr. Chairman and members of the joint committee, is entitled "Preliminary Outline of Testimony."

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[5] SYNOPSIS OF TESTIMONY

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The first approach to our subject is through an analysis of the inherent nature of mine value, the peculiar characteristics of property in mineral deposits conferred upon them by the geological conditions of their occurrence and recognized by man on account of their inherent validity. * * * In short, the whole of his possession in mineral consists of capital, and the measure or value of that capital is the value of the whole of the mineral.

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[6] The oft-stated assertion that the mine owner's right to depletion as a deduction from taxable income rests upon statutory grant and not upon constitutional right is shown to be contradicted within the revenue laws and regulations themselves, by common sense, by general law, and by highest tribunal.

Analysis of the successive revenue laws indicates that they have not proceeded as from a firm basis of theory, principle, and practice relating to mine value and the nature of depletion, but that instead the laws represent a groping for and toward the truth, with, happily, some substantial progress attained in that direction.

But the degree of progress is as yet insufficient to meet a fair test as to satisfactory character. In consequence of deficiency in the law—or which at least the clumsy wording of the law permits to enter in its administration—the mining industry has suffered, and still in substantial measure suffers hardship, discrimination, and unnecessary expense, as well as uncertainty and embarrassment in its proper undetakings.

Relief is imperative and may only be hoped for through such change in the law as will clearly specify the relief required. Fortunately, however, there exists a means whereby modification of the law may be made in the simplest possible manner, namely, by the amendment of a single paragraph in the present law in such a way as to substitute for the existing paragraph a new one which relates to depletion for mines, and which closely accords in form, substance, and spirit with the immediately succeeding paragraph already enacted regarding depletion for oil and gas wells.

The new paragraph proposed as a substitute is as follows:

(2) *Percentage depletion for mines.*—In the case of mines the allowance for depletion shall be 33⅓ per centum of the taxpayer's net income as defined in section 21 (computed (a) without allowance for depletion, and (b) excluding such items of gross income and deductions as are not directly attributable to the operations of mineral or metal production from the property), except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

This simple solution of a long-standing vexatious difficulty *is made possible through utilization of the percentage method for determining depletion, a method simple in its conception and application, but indeed almost magical in its effects.* For its adoption would thenceforth avoid all necessity whatsoever for the troublesome matter of mine valuation, would enormously simplify administration, and would, in our belief, *remove virtually all of the iniquities* and hardships which various portions of the mining industry now suffer, whether judged by standards within the industry itself or as against taxpayers in other groups. [Italics supplied.]

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While the earliest grist of mine valuations was in progress, the bureau became advised of an alternative method of determining a reasonable and proper deduction for depletion, which determination was in most instances the object of valuation. This alternative method was the percentage method, to which allusion has already been made, and it is important to note that earnest recommendations that the bureau forthwith adopt this method were made independently by bureau engineers who came most intimately into con-

tact with the operations and limitations of the analytic appraisal method.

The method of determining depletion as a fixed percentage of net income, before the deduction of depletion, is then clearly discussed, and its derivation demonstrated. It is shown to test in essence on a reduction to present worth of the operating earnings of the property in just the same way that the analytic appraisal method aims to do, and it yields the same kind of separation of these operating profits into return of capital and true profit that the other method does. In fact, the percentage method may be described as the purified essence of the analytic appraisal method whereby all the crudities and uncertainties, all the assumptions and the differences of judgment are mainly, if not entirely, eliminated, and the true answer, or a close approximation to it, automatically furnished in every instance. It affords, year by year from the beginning, the true yearly quantities, of depletion which the mine owner would receive if he were able to know at the outset the exact content, nature and grade of all the profitable mineral embraced within his boundary lines, which constitutes his capital. It makes the determination for each year subject to the facts applicable to that particular year. Like a spring balance, it weighs whatever is placed in its scale pan and automatically returns the correct answer. It is always right, it is never wrong. It is the essence of fairness and justice.

The percentage method of determining depletion has been in sole use for this purpose by the department of national revenue in the Dominion of Canada since the taxable year 1915. And as evidence which we shall present clearly shows, it has been found to give well-nigh universal satisfaction to all concerned

and is enthusiastically suported by taxpayers and government.

[8] *Among the objections that have been raised to adoption of the percentage method in our Federal laws is the assertion that serious administrative difficulties would attend the effort to derive the net income from the property in order that this might be used before deducting for depletion as the base against which the percentage should be applied, to derive the proper depletion allowance. In reply to this objection we present expert testimony to the effect that the bureau has been required for years to determine the net income for mineral property in connection with other provisions of the law and that there is no indication as yet on record to show that such determination has been so difficult as to lead to serious controversy.* On the contrary, experience with the accounts of great and complicated mining corporations, as well as those of more modest dimensions and scope, clearly indicates that there will be no difficulty in determining the net income for purposes of depletion deduction. As provided in the proposed amendment, the net income to be used is that which *should* be used namely, the net income as specified in the act itself, and the use of this net income, which must in any event appear in the tax return of every company, will still further simplify the determination of percentage depletion in the way we recommend. [Italics supplied.]

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* * * We feel, therefore, that your committee has performed a distinct public service in having assembled and published *the preliminary reports on de-*

pletion by your investigating staff, under the leadership of Mr. L. H. Parker. Members of the mining industry appreciate and welcome this highly important information otherwise inaccessible to them. [Italics supplied.]

With the major conclusions of that report on depletion for mines, the group for whom I speak is in general and substantial accord and we find the chief recommendations of that report impressive indeed. [Italics supplied.]

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[12] Mr. GRATON. * * *

The situation is this: To our best belief and knowledge, all members of the mining industry, as distinguished from the gas and oil industry, now believe, if they have not always believed, *that net income for mines is a preferable basis for the use of a percentage method than gross income,* which is adopted in the case of oil and gas companies as the basis against which a fixed percentage is to apply. We think that net income is a far fairer expression of ability to pay, of the measure of the capital that is sacrificed or parted with when the mine owner sells his property. [Italics supplied.]

Mr. COLLIER. Let me ask you one question there, please. Why?

Mr. GRATON. Because value is derived directly through profit. If there is no profit, there is no value, and value is the capitalization of the present worth of the profits to be enjoyed. Net income is the expression of those true profits and, therefore, depletion which is a compensation for the value, the part of the value parted with, within the limits of any taxable year is and must be related in a very definite way to the profits of which it is an expression. The net income, therefore, before depletion deduction shall

have been subtracted from it, is the basis for application of the depletion percentage. Our proposed amendment suggests that 33⅓ per cent of that net income be determined as the appropriate amount.

Mr. COLLIER. Well you are representing the mining industry, and you are now laying down a principle; you think the law as written in reference to the gas and oil industry should be changed from gross also to net income? You are laying down a principle, I believe, now?

Mr. GRATON. Sir, I think it would be preferable—I think it would avoid the possibility of our getting beyond our depth—if we experts, as we believe, in the mining industry seek to confine our presentation to the industry which we know. I do not wish to evade your question, sir.

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Statement of AXEL P. RAMSTEDT, Wallace, Idaho:

Mr. RAMSTEDT. The subject of my remarks is The Nature of Mine Value and of Depletion Unique Character of Mine Value.

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[17] THE NATURE OF DEPLETION

Depletion means literally an emptying or subtracting. In its broad economic significance as applied to mines, it is the loss which the mine owner suffers, or the reduction of his property and capital which he experiences, through the production and sale of mineral. In a somewhat more special and derived sense depletion is used to mean compensation for the loss or reduction so suffered. It is in this last sense of compensation for diminution of property or capital that depletion is used in the revenue laws. The normal

and necessary function of a mine is to produce mineral for sale at a profit, and such production and sale gradually and progressively exhaust the property, [18] because the total quantity of profit-yielding mineral in the property is finite and limited in amount. Depletion is, therefore, experienced for each unit of profitable mineral removed from the property by mine operation.

When we come to inquire how much depletion in the sense of compensation for loss a mine owner must provide for, we find that there is only one true answer. He must provide depletion for all that he removes from the property. Hand in hand with progressive exhaustion must go compensation for such exhaustion. If his productive operation eventually exhausts the entire profitable mineral content of the property, then his progressively accumulated depletion must have been such as to compensate him for such entire exhaustion.

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Having considered the question of depletion determination as a fixed percentage of net income before depletion at several of its previous meetings, the American Mining Congress at its annual meeting in Washington in December, 1929, adopted unanimously a resolution favoring the incorporation into the law of such a method of depletion determination. In conformity with that expression of view, and after conference with responsible members of the Revenue Bureau, and specifically in response to written request by the honorable chairman of the Joint Committee on Internal Revenue Taxation, I submitted to your committee a proposed amendment to the exist-

ing revenue law which specifically approves the determination of depletion by the percentage method as based on net income before depletion allowance has been deducted. That amendment is as follows:

> That section 114(b) of the revenue act of 1928 be amended by substituting for subdivision (2) of said section 114(b), the following:
>
> "(2) *Percentage depletion for mines.*—In the case of mines the allowance for depletion shall be 33⅓ per centum of the taxpayer's net income as defined in section 21 (computed (a) without allowance for depletion, and (b) excluding such items of gross income and deductions as are not directly attributable to the operations of mineral or metal production from the property), except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

While it appears now to be the unanimous feeling of all those who have expressed themselves upon the subject that net income before depletion deduction rather than gross income should be the proper basis for determination of depletion for mines by a percentage method, the foregoing proposed amendment has in all other respects carefully followed, so far as appropriate, the form, substance, and spirit of the succeeding subdivision 3 of section 114(b) of the 1928 act relating to percentage depletion for oil and gas wells, a provision which has been operative since 1926. [Italics supplied.]

The foregoing proposed amendment for mines means that the allowance for mines shall be 33⅓ per cent of the taxpayer's net income before deduction for depletion, carried through to the end of the taxpayer's operation *of mineral or metal production,* provided that the allowance shall not be less than it

would be if computed on the basis of cost or of value as of March 1, 1913. [Italics supplied.]

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Statement of WILLIAM J. FRIEDMAN, of Chicago, Ill., representing the Building Stone Association of Indiana, the Indiana Limestone Co., and the Ingalls Stone Co.:

Mr. FRIEDMAN. Mr. Chairman and gentlemen of the committee, my name is William J. Friedman. I am an attorney of 310 South Michigan Avenue, Chicago, Ill. I appear in behalf of the Building Stone Association of Indiana, the Indiana Limestone Co., and the Ingalls Stone Co.

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I am presenting this case on behalf of the Building Stone Association of Indiana, the membership of which consists of 16 representative companies, the Indiana Limestone Co. and the Ingalls Stone Co. The production of these organizations is 98 per cent of the aggregate amount of Indiana limestone produced. In other words, I am representing practically the entire Indiana limestone industry at this hearing. * * *

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[33] Four methods of revising the present system of depletion are suggested in the preliminary report on depletion submitted to your committee. The operators of Indiana limestone quarries feel that they are entitled to immediate relief from the oppressive administration and operation of the present law. They

will welcome any plan which helps them to obtain the relief to which they are justly entitled.

They have examined the four methods presented (or three, if the two methods of percentage of net income are considered as a unit), and feel that a fixed rate of depletion per cubic foot of stone would probably be most satisfactory. This conclusion is based upon the fact that such a method would probably be the simplest. But in view of the fact that such a basis of depletion may not satisfy the requirements of other mining interests and fulfill the requirements of the Treasury Department as satisfactorily as any of the other methods proposed, the operators of Indiana limestone quarries are willing to accept any plan acceptable to the other mining interests [p. 34] and the Treasury Department which will give them a fair and equitable basis of depletion.

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Statement of J. F. CALLBREATH, Washington, D.C., secretary of the American Mining Congress:

Mr. CALLBREATH. My name is J. F. Callbreath. I am secretary of the American Mining Congress, Munsey Building, Washington, D.C.

Mr. Chairman and gentlemen of the committee, our annual tax conference met in Washington last week. We were favored with an address by the chairman of this committee, and other addresses followed. The conference was unable to agree upon a definite and complete statement to be presented to this committee; but they did agree upon a resolution which I beg to present to you:

> *Resolved*, That it is the judgment of this meeting, representing a large majority of the mining industry, that present United States

revenue laws governing depletion of mines should not be disturbed, except that some amendment to the provisions relative to discovery should be made so as to avoid, as far as possible, discriminations regarding which complaints are now made; and that a committee be appointed by the chairman to prepare such amendment and to take such action as it may deem advisable to further it; and be it further

Resolved, That if provision for percentage depletion is adopted, it should be at a rate of not less than 33⅓ per cent of net income before depletion, and should in no event be less than depletion under existing law.

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Statement of JAMES C. DICK, Salt Lake City, Utah:

THE ANALYTICAL APPRAISAL METHOD OF MINE VALUATION AND THE UNIT METHOD FOR DETERMINING DEPLETION

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I believe one becomes more convinced with the accuracy, justice and equity of the percentage of income method for determining a reasonable depletion the more he studies the question * * *.

[48] *All that the percentage of income for depletion deduction means is that, were we to make an appraisal by the present value method, the factors we would use in the determination of depletion by the unit method have been automatically corrected,* and the annual allowance by the percentage method will be close to the true figure, rather than an erroneous de-

duction that may result from the use of factors based upon assumption or conjecture. We are not estimating the quantity of ore, nor the grade, nor the selling price of metal, nor the metallurgical difficulties that we may have, nor the conditions over which we have no control, but we are basing the deduction on past experience, confirmed by the exhaustive report of the staff of the congressional committee, that 33⅓ per cent is about the proper average deduction from income to compensate for the wasting of the taxpayer's capital in his operation. [Italics supplied.]

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CONCLUSION

From my experience in the Bureau of Internal Revenue, employed as valuation engineer, and as head of the natural resources subdivision, and from experience in the practice of my profession as a mining engineer, I am of the opinion that 33⅓ per cent of the net operating income is a reasonable depletion allowance. I do not believe in a deduction based upon the gross income, as gross income means but little in the operation of a mine. I am fully convinced, however, that a depletion deduction based upon the net income is the true procedure. That to arrive at a reasonable depletion allowance of a property, not fully developed, by determining the value of the unit of metal mined each year by an analytical appraisal, such as is now the present practice of the bureau, does not approach the accuracy which would result by deducting 33⅓ per cent of the income.

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Mr. COLLIER. While I know in this further question I am directing it to one who is not speaking either for the gas and oil industry or qualified as an expert, could you give me any reason why this system, which would be so beneficial to the mining industry, would not also be beneficial to the gas and oil industry?

Mr. DICK. No. I understand, sir, on the contrary, it has been found to be beneficial or satisfactory, to the oil industry. *Of course the depletion deductions of an oil producer are not the same as the depletion deduction of a mine operator. One reason is that oil has a value pretty much as it comes out of the ground. The miner must take his ore, in the majority of cases treat it, operating by concentration or by direct treatment at the smelter.* [Italics supplied.]

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Statement of F. G. HAMRICK, New York, N.Y.:

DETERMINATION OF NET INCOME

[57] It would appear that the determination of net income from the property in connection with discovery depletion has given rise to no serious administrative difficulty. I say this because I have been unable to find any record in the decisions of the Board of Tax Appeals or the courts to indicate that the amount of net income for the purpose of determining depletion based on discovery has been a matter of litigation.

It must be obvious that if administrative difficulties are absent in determining net income from the property for the purpose of applying the limitation in case of depletion based on discovery, they will also be lacking in determining net income from the prop-

erty for the purpose of measuring the depletion allowance.

Even if there did not exist the well established precedent for the determination of net income in connection with discovery depletion, the necessity for determining net income under the proposed percentage depletion plan would not entail either insurmountable complications or even new procedures in administration. The net income before depletion of the company whose activities are confined to mining is reported of necessity in its income tax returns. * * * Where the taxpayer's interests are varied, as in cases of large mining companies, there is, I believe, no doubt that as a rule its books reflect the result of each operation, which makes it possible for the taxpayer to determine to the satisfaction of the Bureau of Internal Revenue *the portion of the income applicable to mining.* Efficient management and good accounting demand that the books of the taxpayer be kept in sufficient detail to furnish such information. [Italics supplied.]

In addition to the assurance our own experience furnishes, we know that the Dominion of Canada has for many years not only determined the net income from mining properties, but has actually applied the net income so determined, as a measure for the depletion allowance by the percentage method. For the purpose of determining the taxable income in the Dominion of Canada, allowable depletion in the case of nickel, copper, lead, zinc, tin, and asbestos properties is 33⅓ per cent of the net income from the property.

[58] For the reasons given herein, it seems certain that the determination of "net income" from mining properties can be computed, and in fact is now being computed, by both the taxpayer and the Bureau of

Internal Revenue. Furthermore, it is evident that the substitution of percentage depletion for discovery depletion would not create any complication whatsoever in the determination of net income. On the contrary, the substitution of percentage depletion for discovery depletion would yield a simpler determination of the depletion allowance than that now required in connection with discovery depletion, since there would be no necessity for valuations, and it would effectively promote the highly desirable end of prompt determination by the taxpayer of the magnitude of his tax obligation.

[63] Statement of JAMES F. MCCARTHY, of Wallace, Idaho, president and manager of the Hecla Mining Co.:

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A MINE EXECUTIVE'S COMPARISON OF UNIT DEPLETION AND PERCENTAGE DEPLETION

Mr. MCCARTHY. My name is James F. McCarthy. I am president and manager of the Hecla Mining Co., Wallace, Idaho.

I am submitting herewith a statement concerning depletion as applied to mines, and a plea for the favorable consideration by your committee of the proposal before you to substitute percentage depletion on net income for the present discovery provision.

Viewing this proposal from the position of the executive or business manager of a mining operation, there appear the following respective advantages and disadvantages:

Advantages in percentage depletion:

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1. Simplicity of the proposed method as contrasted with the present complex method.

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2. Accurate and easily determined basis under percentage depletion contrasted with the lack of accuracy under the present method.

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Statement of Hon. DONALD A. CALLAHAN, of Wallace, Idaho, president of the Callahan Zinc-Lead Co.:

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AN OPERATOR'S EXPERIENCE WITH DEPLETION

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Under the present laws we find that capital is often taxed under the guise of income, and as a result not infrequently one miner is compelled to pay twice the taxes of his neighbor who to all intents and purposes is similarly circumstanced. The properties are alike as two mines may be, costs are identical, the product is sold in the same market at the same price, and operating earnings are equal; yet, through the workings of the system for computing the depletion deduction, one pays twice the taxes of the other. Through the presence or absence of fortuitous circumstances over which the owners have no control, one man receives no recognition whatever of capital value and has no depletion and pays tax on both capital and income, while the other, under the discovery clause, is allowed, and properly so, the return of his capital values free of tax. * * *

[95]

We are willing to accept that suggestion and *that is why we are before this committee presenting a simple, practical, workable plan for doing away with the gross discrimination and injustice unavoidable*

under the present law. In this endeavor we ask the cooperation and assistance of the bureau and the Treasury Department. * * * [Italics supplied.]

[104] Statement of B. H. BARTHOLOW, Special Assistant to the Secretary of the Treasury:

Mr. BARTHOLOW. B. H. Bartholow, Treasury Department, Washington, D.C.; special assistant to the Secretary of the Treasury.

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[110] * * * Therefore the allowance of percentage depletion in the mining industry would effect a vast change because it would grant to all instead [p. 111] of relatively few the special tax benefit or exemption, which Congress has heretofore accorded only to those who risked their capital and made discoveries of new ore bodies. Furthermore, while the bureau is having difficulty in administering the percentage depletion provisions in the case of oil and gas wells, the Treasury believes that the problem of administering like provisions in the case of mines would be infinitely greater. The foremost reason is that the field price of the oil or gas at the well indicates the income from the property, while in the mining industry, where there is no general field price for the ore at the mine and where the larger taxpayers do their own concentrating, smelting, refining, transporting, and marketing, all that is known is that the refined or fabricated product was sold for a certain amount. *There is thus presented the insuperable difficulty of dividing up the resulting income among all those various activities—marketing, transporting, smelting, refining, mining, etc.—and then allocating the proper portion to the mining operation which would be the income from the mine.* [Italics supplied.]

[114]

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Mr. COLLIER. There is one thing I want to ask you in regard to the change of the law in 1926, in which we first went to the percentage basis on gas and oil wells and gave them 27½ percent depletion on gross income: How is that working out? Is that satisfactory both to the Government and the taxpayers now; has it proved a success?

Mr. BARTHOLOW. My information relates to its administration. Numerous complicated, technical issues having to do with the determination of the net income even from oil properties, where there is a field price, have arisen, and there are still unsettled technical problems of all kinds. I could enumerate a few here, but they are quite detailed. This much is certain, those who are administering the law find the percentage depletion provisions more difficult to administer than the provisions for basic depletion.

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Further statement of L. C. GRATON.

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We have been greatly interested in the preliminary report on depletion. We commend Mr. Parker for the work that he has put on it and for the conclusions that he has drawn, and the committee for its vision in having such information made available. Although we can not fairly say that we agree with all the details included in that report, as perhaps is not to be expected, we do feel that it is an earnest, constructive, contribution and, with its fundamental considerations, we find ourselves in absolute accord.

We have no fear of meeting, with absolute conclusiveness, the presentation made by the Treasury De-

partment this morning. * * * [128] As to the question of revenue, it was indicated that the facts were not sufficient to make a final conclusion, but the estimates were that, for the metal-mining industry, the whole of the metal-mining industry, if discovery depletion were displaced by percentage depletion, the loss to the Government might be estimated at $200,000 for that year, with an indication that such loss would gradually decline. And that $200,000, it was said, along with similar estimates for some of the other industries, was a very conservative estimate, so far as the Treasury is concerned, and the chances were that the true loss would be less than the estimate.

Now that appears as the most approximate, the most definite estimate of the effect on revenue of the percentage depletion scheme that I have learned and, as far as I can see, if that applied, as I imagine it did, to the tax year of 1926, *it would mean a reduction of revenue of one and a half per cent of the taxes paid by the whole of the metal mining industry.* [Italics supplied.]

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1932

[Percentage depletion was extended to coal, sulphur and metal mines in the Revenue Act of 1932, c. 209, 47 Stat. 169. The Ways and Means Committee made no recommendation in that connection. Sulphur was added on the House floor at 27½ percent. The Senate Finance Committee reduced this to 23 percent and added metal mines at 15 percent (S. Rep. No. 665, *infra*, pp. 130–131). Coal, at 5 percent, was added on the Senate floor (75 Cong. Record 10418–10419) and the House conferees accepted the Senate amendments (H. Conference Rep. No. 1492, *infra*, pp. 131–132). Maferial excerpts from the hearings, and reports fol-

low, together with the statute and the Treasury Regulations which were subsequently promulgated in implementation of the statute.]

House Hearings, 1932

(Revenue Revision, 1932, Hearings before the Committee on Ways and Means, House of Representatives, 72d Cong., 1st Sess.)

[327] BASIS FOR DEPLETION ALLOWANCE

Statement of BERT E. HANEY, Portland, Oreg., representing the Northwest Mining Association:

Mr. HANEY. Mr. Chairman and gentlemen, I represent the Northwest Mining Association, and I want to make a few remarks with respect to the subject of depletion of mines. It is unnecessary to do more than this, because this matter was very fully presented to the joint committee on internal-revenue taxation at hearings held December 9, 10, 11, and 12, 1930. Those hearings were published and are of course available to members of this committee. Moreover, there are four members of this committee who were also members of the joint committee on internal-revenue taxation when those hearings were held.

Our cause for complaint at these hearings rested primarily upon the following contentions: *First, that depletion allowances in the case of mines are inequitable as between taxpayers in the same industry;* second, that the depletion allowances were uncertain and were subject to excessive controversy; third, that the determination of the depletion allowance was expensive both to the Government and to [328] the taxpayer, and we still rest our appeal for relief on those three contentions. [Italics supplied.]

When I say relief, I do not wish the members of this committee to infer that in these times I am asking

for anything which will decrease the total taxes paid to the Government by the mining industry. What we are asking is that the total of the allowances now made be spread *in an equitable manner over all taxpayers in the industry,* so that all may compete on an equal basis. [Italics supplied.]

Under the present system some properties are receiving no depletion allowance, while competing properties are practically exempt from taxation by virtue of such allowances.

It may well be asked, can this be done? My answer is plainly, yes. Congress itself has answered this question by abolishing the depletion system for oil and gas wells as early as 1926, and adopting a system based on a fixed percentage of income. Moreover, Canada has long used the percentage-depletion system for all of its mines and its oil properties with marked success. The identical system which was abolished for oil and gas wells in 1926 is the same inequitable system which remains in the law to-day with respect to mines.

The group which I represent *urges that the inequities of the mining industry with respect to depletion be eliminated* as they were in the case of oil and gas wells by applying the percentage system. *In our case we would have no complaint if the percentage should be applied to net rather than to gross income,* although the net income basis is less favorable to the taxpayer. However, since the technical staff of the joint committee on internal-revenue taxation, in its exhaustive report published on this subject, suggests the net basis as being more certain to render a fair revenue to this Government, it appears proper that there should be no controversy raised on this particular phase of the subject. In fact, at the hearings before the joint committee my group asked for depletion based on a percentage of net income. In the hearings before the

joint committee facts were shown that indicated a depreciation allowance of 33⅓ percent on the net income would be fair allowance and not result in decreased taxes. This appears to have been the conclusion urged in the report of the staff of the joint committee. However, our particular group will not attempt to dictate to the committee what that percentage should be. We will be content to rest entirely upon the fairness with which you have treated past problems and with which we think you will undoubtedly treat this problem. [Italics supplied.]

The *inequities in the present system* came about very largely because of the difficulty in valuing mines. * * * [Italics supplied.]

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[329] Just one more word before I close. At the present time the Government should make a substantial gain in revenue by adopting the percentage depletion system. Profits now are low and in many cases the depletion allowance completely eliminates the net income, so there is no tax. Under the percentage plan, if there is no operating profit before the depletion deduction is taken, then at least 66⅔ percent of that income will be subject to a tax, and any measure which will equalize the revenue between the years of high and low profit should appeal to this committee now that we are faced with a deficit which is somewhat attributable, at least in part, to a sudden decrease in the income tax collections.

In conclusion, Mr. Chairman, I want to appeal to the committee to correct the *present inequitable depletion system* in the present bill. It is vital to many of our taxpayers, if they are to be permitted to exist at all in the mining business. We can not compete under heavy taxes with those similarly situated mining the same kind of ore at the same cost, who are

paying no taxes. * * * [Italics supplied.]
[330]

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The CHAIRMAN. When the American Mining Congress were opposing this, I understood you to say it was a divided question with them, that they were not, as an organization, opposing it. Am I right in that?

Mr. HANEY. May I state my understanding of it, Mr. Chairman? My understanding of the matter is that the Mining Congress has not in recent years taken a position for or against percentage depletion, that there is a division concerning that subject within the membership. The Mining Congress is made up of gold miners, silver miners, lead miners, tin miners, coal miners and many other kinds of miners. Some of the groups take our position, some of the groups in the Mining Congress, noticeably the gas and oil people, are not enthusiastic about this plan. They already have it. They have what we are asking for.

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[331] Mr. LEWIS. Mr. Chairman, if no others wish to ask questions, I would like to ask quite a few.

Mr. CHINDBLOM. Then, let me ask one, if I may. The basis for depreciation and depletion set forth in section 114 gives special rules only *as to mines, or minerals being the product of mines,* and oil and gas, being the product of wells, producing those articles. Are there any other classes of property, or classes of production, to which similar or special rules might be applied in justice or equity to these three classes? [Italics supplied.]

Mr. HANEY. I do not know whether I understand you, but I will try to answer you, sir. To start with, I understand that with respect to gas and oil the depletion is computed on a percentage basis under the present act, that with respect to ore mines, it is com-

puted on this so-called analytical method. Depletion in a mine is not—and you will bear with me when I say I am not a miner, sir, and I am discussing a rather technical subject—depletion in a mine is not exactly the same thing as depreciation in other personal property, but it is somewhat akin to it. Depletion in mining is a method of determining what is capital and what is profit. * * * The trouble is that our present system is so purely a matter of guess that it has resulted in glaring inequalities, inequalities where two men in the same community, operating the same kind of a mine, at the same price, and producing the same ore, one of them is paying an enormous tax and one paying no tax, both of them honest, one of them a good guesser, and one not.

* * * * *

[335] Mr. LEWIS. What is your suggestion?

Mr. HANEY. *I say this method is just another method of computing that depletion, and it is the same method and will provide the same result as the present method would produce if there were no mistake ever made in the present method.* [Italics supplied.]

* * * * *

[336] Mr. CHINDBLOM. I was going to ask whether Mr. Parker and others who are always available to us will not discuss this matter when the committee takes it up?

[337] The CHAIRMAN. Mr. Chindblom, I think our understanding is when we meet to go into consideration of the drafting of the bill, *we expect to have Mr. Parker and other experts with us to take up all these propositions and discuss it with them before the committee reaches any conclusion.* [Italics supplied.]

* * * * *

Statement of E. T. CUMMINS, Washington, D.C., representing Domestic Sulphur Producers.

Mr. CUMMINS. Mr. Knoblock has asked me to represent him and present certain matters to this committee in which we are jointly interested.

Mr. CRISP. You represent whom?

Mr. CUMMINS. I represent one of the sulphur companies interested in the matter, the Freeport Sulphur Co.

The Freeport Sulphur Co., the Texas Gulf Sulphur Co., and the Duval-Texas Co. ask you to make a slight amendment to section 114(b)(3) of the 1928 revenue act, which deals with depletion of mines, or particularly the oil and gas section of that provision.

We are not here asking for any relief from the paying of taxes, but only that certain matters involving valuation and resulting depletion be clarified or simplified. *In other words, we are asking to be put in the same class as that of the oil and gas industry regarding depletion.* Our particular reasons for this request is that the production of sulphur is very similar to that of oil and gas. More so than the ordinary mining operations that are carried on by the mining industry. That [338] is, we drill holes for its production, pump it out of the ground and recover by that method. [Italics supplied.]

Our relations are always with the oil people, inasmuch as they usually operate on the same dome, or along with us, or own an interest in the property from which we obtain production.

The section we ask to be amended now reads:

> Percentage depletion; in the case of oil and gas wells, the allowance for depletion shall be 27.5 percent of the gross income from the property.

All that we are asking you to do is to insert the word "sulphur" so that section will read "in the case of sulphur, oil and gas wells," and we believe and are sure that the insertion of this provision into the law will clarify it and make it more simple in its operation. It will let us know where we stand with regard to our taxes each year as they are due. It is not going to reduce our taxes and it will be cheaper in its operation, that is, so far as the Government is concerned, and cheaper for us.

I shall be glad to answer any questions relative to this proposal that you gentlemen may care to ask. I would also like to present our brief on the subject and ask permission to have it printed in the record.

Mr. CRISP. You have that permission, and on behalf of the committee we thank you for your presence.

(The brief is as follows:)

BRIEF ON BEHALF OF SULPHUR PRODUCERS

CHAIRMAN WAYS AND MEANS COMMITTEE,
House of Representatives of the United States.

DEAR SIR: The following brief is submitted on behalf of the Freeport Sulphur Co., Texas Gulf Sulphur Co., and Duval-Texas Sulphur Co., being all of the producers in the United States of sulphur by the Frasch process; that is, recovery through driven wells. They represent in excess of 99 percent of the total production of sulphur in the United States. (See Mineral Industry, 1930, p. 560.)

These producers unite in requesting an amendment to section 114(b)(3) of the revenue act of 1928 so as to include sulphur in the percentage depletion granted to oil and gas wells.

* * * * *

[339] I. THE MINING AND PRODUCTION OF SULPHUR BY THE FRASCH PROCESS BY USING DRILLED WELLS RENDERS THIS MINING OPERATION MORE SIMILAR AND ANALOGOUS TO OIL AND GAS WELLS THAN TO METAL MINING

The Frasch process of mining sulphur (under which over 99 per cent of the production in the United States is obtained) is:

First, to sink a well into the caprock which overlies the corck salt core of the salt dome in which these deposits of sulphur occur. These wells are drilled with a rotary rig similar to that employed in the petroleum industry for work in soft formations. Second, into this same well is pumped water heated under pressure to a temperature above the melting point of sulphur. This melts the sulphur in situ. Third, it is then pumped to the surface by compressed air. The sulphur arrives at the surface in a liquid form. Fourth, it is then distributed into bins where it is allowed to solidify, for immediate sale and distribution. *The sulphur so recovered is in excess of 99.5 per cent pure and is of the grade used in commerce. It requires no further treatment or refining to prepare it for the trade.* [Italics supplied.]

* * * * * *

II. SIMILAR TO OIL AND GAS SULPHUR IS A COMMERCIAL PRODUCT AT THE MINE AND DOES NOT HAVE TO BE SUBJECTED TO A FURTHER TREATMENT FOR SALE

Sulphur, like oil and gas, has a value as it comes out of the ground. Similar to oil and gas there is an established field price for sulphur which indicates directly [*p. 340*] *the income from the property.* In the case of ores of the metals there is no general field price for the ore at the mine and when the taxpayer does its own concentrating, smelting, refining, trans-

porting and marketing, all that is known is the selling price of the refined or final product. *Contrasted with this situation of the ores of the metals sulphur, oil, and gas have a field price and no profit derived from the process of their further treatment could be the subject of depletion.* [Italics supplied.]

Percentage depletion, therefore, is peculiarly appropriate for sulphur, together with oil and gas wells, and avoids the difficulty existing in the case of metal mines of allocating the proper portion of the income between that which was due to the mining operations simpliciter and that which was due to smelting, refining, transporting, etc.

* * * * *

[341] VI. NUMEROUS TAX QUESTIONS ARISING OUT OF THE DISTRIBUTION OF DEPLETION DIVIDENDS WILL BE AVOIDED

* * * * *

We need not dwell upon the various other general arguments in favor of the percentage method, such as its simplicity, accuracy and ease of determination, economy of administration, prompt settlement and equality, which have already been stressed by others before this committee.

We base this application upon the close association of ownership and discovery between sulphur and the oil and gas wells, the multiple nature of the various interests in the sulphur domes and the unique method of producing and mining sulphur, essentially similar to that of producing oil and gas, and the fact that *there is for sulphur, as for oil and gas, a field price that avoids any allocation in determining the income to which percentage depletion is applicable.* [Italics supplied.]

SUMMARY OF ADVANTAGES

The advantages may be briefly summarized as follows:

1. The production of sulphur in the United States is analogous to the production of oil and gas.
2. It would eliminate the complex question of valuation for depletion purposes.
3. It would be simpler in its administration.
4. It would be accurate and easily determined.
5. It would allow prompt settlement.
6. It would produce equality in the result.

All of which facts we submit warrant the classification of sulphur producers of this country for depletion with the oil and gas industry.

Respectfully submitted.

H. F. J. KNOBLOCH.
E. T. CUMMINS.

* * * * * *

[342] BRIEF OF THE NATIONAL COAL ASSOCIATION AND SUNDRY DISTRICT ASSOCIATIONS OF BITUMINOUS MINE OPERATORS

WASHINGTON, D.C., *January 23, 1932.*

TO THE WAYS AND MEANS COMMITTEE,
House of Representatives, Washington, D.C.

GENTLEMEN: The signers of this brief urge your earnest consideration of the following statement regarding the need of the coal mining industry for relief through appropriate modification of the present depletion provisions of the internal revenue act. The brief is submitted on behalf of bituminous mine operators with the indorsement of their national organization, the National Coal Association, and of the local and district associations in the industry whose signatures are appended below.

We feel that we are justified in demanding such relief on the general ground that however uniform and equitable the present depletion provisions may sound, in practice they have been applied in such a way as to amount to a serious discrimination against the coal mining industry as compared with other mining industries.

It is a well-recognized principle of taxation that no system can be regarded as equitable under which the burden of taxation rests unequally upon different taxpayers of the same class. As will be demonstrated herein, the coal mining industry for many years has been taxed to an inequitable extent in comparison with other mining industries. * * *

The inequitableness of the tax burden laid upon the coal mining industry arises chiefly from the practical effect of the present provisions of the internal revenue act relating to the depletion of mining properties. * * *

Apart from the petroleum industry all mining industries seem to be treated alike in the matter of depletion so far as the wording of the statute is concerned. In the practical application of the law, however, great inequalities have arisen. These have resulted chiefly from two causes.

In the first place, the coal mining industry in 1913 was in a very depressed condition. Consequently the values established for coal lands at that time were inadequate. There were few sales of mining properties, and those that took place were made under circumstances tending to reduce rather than maintain established values. For lack of current earnings few companies were able by the use of the analytical appraisal method to provide adequate value for their mining properties. * * *

In the second place, the coal-mining industry has derived no benefit from the discovery-value provision of the act, while other branches of the mining industry have been able to set up current values for substantial percentages of their output through their ability to take advantage of this principle. * * *

* * * * *

[343] The effect of these dissimilar conditions upon the amount of tax paid by the coal-mining industry is shown in the analysis of taxes actually paid by the different branches of the mining industry. Such an analysis is contained in the preliminary report on depletion, rendered to the Joint Committee on Internal Revenue Taxation, by L. H. Parker, chief of staff, and by that committee submitted to Congress on September 17, 1929.

* * * * *

* * * These figures are direct and conclusive evidence of the inequitable results of the present statutory provisions relating to depletion and the administrative application of those provisions.

Another indication of the inequitable results of these depletion provisions may be briefly pointed out without comment. From the figures given in the third table on page 8 of Mr. Parker's report it is possible to compute for the single year 1924 the ratio of depletion allowances to gross sales. * * *

[344] Mr. Parker's final conclusion as to the injustices resulting from the practical application of the present depletion provisions, and especially the hardship imposed by them upon the coal industry, deserves to be quoted in full (see p. 22):

* * * * *

In view of the conclusively established injustice inflicted upon the coal mining industry as the result

of present rules and practices relating to mine depletion, your petitioners, speaking on behalf of the bituminous mining industry of the country, feel that they are justified in requesting relief through changes in the income tax law so far as it relates to depletion allowances. We respectfully urge that the present provisions relating to depletion be amended by the insertion of the following paragraph (3) immediately after the present paragraph (2) of section 114 of the revenue act of 1928:

"(3) *Percentage depletion for coal mines.*—In the case of coal mines the allowance for depletion shall be 33⅓ percent of net income before depletion; provided that such depletion allowance shall not be less than 5 percent of the gross income from the sale of coal at the mine; and provided, further, that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

* * * * *

[345] The proposed amendment provides for an alternative depletion allowance of 5 per cent of gross income from the sale of coal. *The immediate purpose of this provision is to take care of companies producing so-called captive tonnage. Many such companies owned by railroads, electric power plants, steel mills or other industries sell no coal in the open market but deliver their entire output to the parent company.* The aggregate amount of such tonnage in the coal mining industry is very large. In many instances the price at which the tonnage is transferred from the subsidiary to the parent company is arbitrarily fixed and bears no relation to current market value. Indeed in some States utilities owning subsidiary coal-mining companies are required by law to take over the tonnage of such subsidiaries at cost. In the case of the last mentioned companies there is no

figure on the books representing net profit. Unless such companies are to be entirely deprived of depletion allowances provision must be made for computing such allowances on the basis of gross income from the sale of their product. [Italics supplied.]

The only alternative method that can be applied to such companies is an arrangement under which the Commissioner of Internal Revenue will set up a constructive net income based upon market conditions at the time and place of the transfer of the product. Arrangements imposing upon the Commissioner the duty of constructive action of this kind have never proven satisfactory. * * * The construction of a theoretical net income for companies producing captive tonnage will prove equally unsatisfactory as a method of arriving at the depletion allowance of subsidiary companies of the kind under consideration.

The provision for an allowance of 5 per cent of gross income will have wider application. Without regard to the effect of the present depression upon the coal-mining industry its financial experience in recent years has been very unsatisfactory. The period 1928 and 1929 to October of the latter year was one of unexampled prosperity for industry in general. Even during those years the coal-mining industry was far from prosperous. The Statistics of Income, issued by the Bureau of Internal Revenue, show that in 1928 two-fifths of the coal-mining companies reported net losses for the year and that the losses so reported exceeded the net income reported by the remaining companies by nearly $20,000,000; in 1929 nearly two-thirds of the companies reported no net income and the aggregate losses of these companies exceeded the net income of the remaining companies by nearly $9,000,000. In other words, in those two years the coal-mining industry as a whole not only

had no net income but was substantially in the red.

* * * * *

It is obvious that in a year in which the coal-mining industry as a whole operates at a loss, a depletion allowance computed as a percentage of net income will not be a measure of substantial relief. If in such a period the industry is to be relieved from the inequitable burden of taxation under which it now suffers, its relief can not come solely from a provision giving it a depletion allowance based on net income. Only an allowance computed as a percentage of gross income can adequately meet the situation. * * *

* * * * *

[346] The position of the coal-mining industry with reference to this question of depletion is briefly as follows: The industry has always been and still is the victim of an inequitable distribution of the income-tax burden. * * *

* * * * *

[347] National Coal Association, Washington, D.C., Carroll B. Huntress, executive secretary; * * *

Senate Hearings, 1932

(Hearings before the Committee on Finance, United States Senate, 72d Cong., 1st Sess., on H.R. 10236.)

[224] Statement of DONALD A. CALLAHAN, of WALLACE, IDAHO, representing Northwestern Mining Association.

* * * * *

I am not appearing here in opposition to anything in the way of tax, but I am appearing here in support of an amendment which was offered by Senator Thomas of Idaho, and which would provide as the

basis of depletion in metal mines a percentage rate of 15 per cent *of the gross.* [Italics supplied.]

* * * * *

[225] Depletion of mines under our income tax laws means an annual deduction from gross income of an amount which is estimated will compensate the miner for the capital which has been used up or destroyed through the operation of his mine during the year. Obviously all the ore in his mine at the beginning of his operation is capital. Plainly, also, when he takes that ore out of the mine and sells it he has disposed of his capital. Our income tax laws have never attempted to tax him on that portion of the proceeds of his sales which may be regarded as a return of captial. The only question which has been considered in past income tax laws, and which is being considered here, is: "What is the proper method of ascertaining the amount of the proceeds of his sales *of ore* which may be regarded as return of capital and upon which he should pay no tax?" Looking upon it from another angle it may be said that depletion for mines represents the same element as the cost of raw materials in a manufacturing process. [Italics supplied.]

* * * * *

SENATOR BINGHAM. Mr. Chairman, may we have a copy of Senator Thomas's amendment so that we can have it before us? Has it been printed?

The CHAIRMAN. Yes.

(The amendment is as follows:)

Amendment intended to be proposed by Mr. Thomas of Idaho to the bill (H.R. 10236) to provide revenue, equalize taxation, and for other purposes, viz:

On page 84, line 15, after "for" insert "metal mines,"; and beginning with the word "In" in line 16 strike out through the period in line 19 and insert in

lieu thereof the following: "The allowance for depletion shall be, in the case of metal mines, 15 percent, and in the case of sulphur, oil, and gas wells, 27½ per cent of the gross income from the property during the taxable year."

* * * * * *

[226] Mr. CALLAHAN. 1929. The figures that have been compiled by the Joint Committee on Internal Revenue Taxation, and which are contained in the preliminary report that was presented, covers those very figures. It covers them not for one year but over a period of years. In which it is shown that the average of depletion allowed amounted to better than 17 per cent.

SENATOR REED. On gross?

Mr. CALLAHAN. Yes. Those figures are in this preliminary report which was prepared by Mr. Parker and his staff.

* * * * * *

[227] Mr. CALLAHAN. * * * Now we are in a different position than we were when these bills were originally written. We have back of us here a world of experience in production and all that sort of thing. We know what the percentage of depletion now would mean as related to what depletion has actually been allowed in the past, and we have purposely placed this even lower than the figure which the weighted average shows at the present time in order that there will be no decrease in revenue, and we contend that there will be an actual increase in the stability of revenue, because * * *

[228] * * *

SENATOR COUZENS. Leaving out of consideration your district, do you think that the 15 per cent is fair to all districts?

Mr. CALLAHAN. I think it is fair to all districts because it is the nearest approach to the average that

we can attain. And I think it is absolutely fair. It is our opinion that it is fair. Never been denied that it was not fair.

SENATOR KING. How can you establish a uniform rule, Mr. Callahan, when you have different conditions in different places? * * * It seems to me it is difficult to establish uniform plans for the purpose of applying the rule of depletion.

Mr. CALLAHAN. It is very difficult. Not only difficult, but absolutely impossible *under the present plan.* [Italics supplied.]

* * * * *

[229] Mr. CALLAHAN. * * *

There are three sources, of course, of opposition to this. * * *

But we are firmly convinced that the application of the percentage method will do away with a large amount of the expense of the department. It will do away with a tremendous amount of expense to the taxpayer in first establishing his valuations and afterwards maintaining them. That it will mean a more stable revenue if it is adopted with the provision that it can not exceed 50 per cent of the net. And it will mean this, that valuations will not be established, as they have been in the past, in times of high prices, when there was a big price for a unit of ore, and then depleted at a time of lower prices. * * *

* * * * *

[230] SENATOR COUZENS. Before you get to that point. The adoption of this plan would put you all on the same basis?

Mr. CALLAHAN. *The adoption of this plan would put us all on the same basis, absolutely.* [Italics supplied.]

SENATOR COUZENS. And these concerns that now have this big advantage taken away?

Mr. CALLAHAN. Yes.

SENATOR KING. It would inure to your advantage in a little way, but to the disadvantage of some others that you think now have an advantage?

Mr. CALLAHAN. No; I do not think it would inure to their disadvantage. No, I do not think it would. I think they imagine it would. And there is also a tendency of those going along in business to say, "Let well enough alone."

The CHAIRMAN. I can not conceive of any mine, unless it was a wild-catter, but that this amendment would be an advantage to.

Mr. CALLAHAN. I think it would. Not in the matter of taking away revenue from the Government, but in the matter of their carrying on their own business.

* * * * *

[231] SENATOR REED. Mr. Callahan, what would be your feeling toward basing your depletion upon a percentage of net income instead of gross?

Mr. CALLAHAN. Well, probably we would favor that. *It has been figured out that 15 per cent of gross will amount to about as much as 30 per cent of net. That is the experience. And we would have no objection to figuring it on that basis.* [Italics supplied.]

SENATOR COUZENS. It seems to me that to figure on percentage of net would encourage extravagance.

Mr. CALLAHAN. Yes. This is simpler.

SENATOR COUZENS. Do I understand that if this plan were adopted it would be necessary to eliminate the discovery percentages?

Mr. CALLAHAN. It is not necessary to eliminate, but you gentlemen know and I know that it should be eliminated.

SENATOR COUZENS. Would not those who get a discovery allowance have an advantage over you if this plan were adopted and you only got the percentage?

Mr. CALLAHAN. It would be an advantage temporarily, perhaps, but it would not be an advantage that would be continuous. And what we are asking is a permanent change of policy with regard to this thing, which we feel will be to the advantage of all mines and will be tremendously to the advantage of the Government.

[232] May I now say in conclusion that a number of the States have recently adopted income tax laws. Senator Smoot's State of Utah, after a thorough investigation by a commission, adopted an income tax law, and they incorporated in that after their investigation the percentage method of depletion.

SENATOR REED. Based on gross?

Mr. CALLAHAN. I do not know whether theirs is based on gross or net.

The CHAIRMAN. On net, I think.

Mr. CALLAHAN. On net. Our State of Idaho based theirs on net. The State of Oregon and the State of California—all of those that have recently enacted income-tax laws—provided the percentage depletion for mines in their laws.

SENATOR COUZENS. On net or gross?

Mr. CALLAHAN. Well, I think they are principally on net. I think that that was done in all of them. I know it is in our State.

SENATOR COUZENS. Why did they adopt net and you recommend gross?

Mr. CALLAHAN. Well, as a matter of fact there has been just a question always as to which is which.

SENATOR REED. *As a matter of fact it is based to some extent on both where you say that it shall not exceed 50 per cent net.* [Italics supplied.]

Mr. CALLAHAN. Yes, it is. This, of course, has that saving provision. But, as I say, the estimate from the figures is that this amounts to about 30 per cent on net.

I am filing this statement, Mr. Chairman.

The CHAIRMAN. Very well, that may be placed in the record.

(The statement presented by Mr. Callahan is here printed in the record, in full, as follows:)

Statement of DONALD A. CALLAHAN, of WALLACE, IDAHO, representing Northwestern Mining Association:

I am appearing in support of the amendment offered by Mr. Thomas of Idaho relative to the allowance for depletion in the case of metal mines.

* * * * *

[233] As a result of the administration of this law we find tremendous inequalities between taxpayers who are engaged in the same line of business. * * *

* * * * *

[234] Besides these inequities as between different branches of the industry and different districts in which the same metal is produced, there are also tremendous inequalities as between individual taxpayers. * * *

* * * * *

[235] * * * There are companies operating to-day that have a depletion valuation per unit for their ore in the ground higher than the price which they receive for their finished product.

Under the percentage plan this could not occur, if the limitation of deduction for depletion be fixed, as it is in this amendment at 50 per cent of net income. Under the present system a taxpayer may show a profit before depletion and wipe it out completely by deple-

tion allowance. Under a straight percentage plan, with a limitation such as in the amendment, he must, in any event, pay upon 50 per cent of that net income.

There is proposed in this amendment a plan by which, instead of the involved processes now employed, the taxpayer may deduct 15 per cent of his gross income, provided it does not exceed 50 per cent of his net income. There will be no valuations, no estimates, no predictions. It is the same principle as was applied by Congress to the oil and gas industry, with a different rate because of the difference in the nature of the two industries.

The question may be asked "Why the rate of 15 per cent of gross?" That rate has been determined as one which, according to actual experience will amount to less than the average of depletion which has been allowed in the past. These figures are given in the Parker report, heretofore referred to, at page 67. I think it is agreed as between the Bureau of Internal Revenue and the mining industry that the average of depletion allowance has been above 17 per cent of gross. The amendment here offered, therefore, will result not in a lessening, but in an increase of revenue, and because of the fact that not more than 50 per cent of net can be deducted will, in my judgment, result in a considerable increase and a much more stable income to the Government.

* * * * *

[236] Brief submitted by National Coal Association and District Association of Bituminous Mine Operators.

PERCENTAGE DEPLETION ALLOWANCE FOR BITUMINOUS COAL MINES

TO THE FINANCE COMMITTEE,
United States Senate, Washington, D.C.

* * * * *

[This brief, which appears on pages 236–242, is identical to the one submitted during the hearings before the Ways and Means Committee, portions of which are printed *supra,* pp. 117–122.]

S. Rep. No. 665

(72d Cong., 1st Sess., pp. 16, 30: (1939–1 Cum. Bull. (Part 2) 496, 507))

Sec. 23(l). DEPLETION.

* * * * *

The cross reference contained in the House bill to section 114(b)(3) relating to percentage depletion is changed in view of the fact that percentage depletion has been extended to metal mines as well as to sulphur and oil and gas wells.

* * * * *

Sec. 114. BASIS FOR DEPLETION.

The amendment to paragraph (b)(2) as contained in the House bill makes it clear that in the case of metal and sulphur mines the depletion allowances may not longer be computed upon the basis of discovery value.

Paragraph (b)(3) of the House bill has been amended by the elimination of the word "sulphur" to restrict the application of the paragraph to oil and gas wells.

Sec. 114(b)(4). PERCENTAGE DEPLETION FOR METAL MINES AND SULPHUR.

Under paragraph (b)(4) metal mines are granted a percentage depletion allowance of 15 per cent, and sulphur mines or deposits of 23 per cent of *the gross income from the property* during the taxable year. As in the case of oil and gas wells this allowance can not exceed 50 per cent of the net income of the taxpayer from the property. In respect to the taxable years 1932 and 1933 the taxpayer is privileged to have

the greater of either (1) the percentage depletion allowance or (2) an allowance computed on the adjusted basis provided in section 113(b) (usually cost or March 1, 1913, value, with adjustments). This privilege is the same for those two years as that accorded both under the existing law and the bill in the case of oil and gas wells for all years. [Italics supplied.]

In the return for the taxable year 1933, however, the taxpayer is required to state as to each property whether he elects to have the depletion allowance for such property for succeeding taxable years computed with or without reference to percentage depletion; this election must be as between either percentage depletion or depletion computed upon the adjusted basis. In the case of any property in respect of which a return is first made in a year subsequent to the taxable year 1933, the election indicated in the return for such year shall be binding as to all future years. If the taxpayer fails to make such election in the return in which it should be indicated, the depletion allowance for that and succeeding taxable years will be computed on the adjusted basis.

H. Conference Rep. No. 1492

(72d Cong., 1st Sess. (1939–1 Cum. Bull. (Part 2) 539))

* * * * *

[14] AMENDMENT No. 54: This amendment changes the rate of percentage depletion in the case of sulphur from 27½ per cent, as in the House bill, to 23 per cent, of the *gross income from the property,* and allows percentage depletion in the case of coal and of metal mines, at the respective rates of 5 per cent and 15 per cent of the *gross income from the property;* the percentage depletion allowance can not in any

case exceed 50 per cent of the net income from the property. As in the case of oil and gas wells the amendment makes it clear that rents and royalties paid or incurred by the taxpayer in respect of the property are to be excluded in computing the gross income from the property. The amendment requires that the taxpayer make in his 1933 return an election, binding for 1934 and subsequent years, whether he will have the depletion deduction as to each property computed with or without reference to percentage depletion, and the failure so to elect will preclude the use of percentage depletion. The amendment also provides that if, because of the provisions of section 113(a) of the bill, the basis of property acquired after December 31, 1933, is determined either (1) by reference to the basis of the property in the hands of a transferor, donor, or grantor or (2) by reference to the basis of other property previously held by the taxpayer, then the method of computing the depletion allowances in respect of the property so acquired, shall be the same as the method previously used by the transferor, donor, or grantor, or by the taxpayer in [15] respect of the property previously held. The House recedes with a clerical amendment. [Italics supplied.]

* * * * *

Revenue Act of 1932

(c. 209, 47 Stat. 169)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in

each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * * In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * * * (For percentage depletion, see section 114(b) (3) and (4).)

(m) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*— * * *

(b) *Basis for Depletion.*—

(1) *General Rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

(2) *Discovery value in case of mines.*— * * *

* * * * *

(3) *Percentage depletion for oil and gas wells.*—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

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(4) *Percentage depletion for coal and metal mines and sulphur.*—The allowance for depletion shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the *gross income from the property* during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. [Italics supplied.] Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance for the taxable year 1932 or 1933 be less than it would be if computed without reference to this paragraph. A taxpayer making return for the taxable year 1933 shall state in such return, as to each property (or, if he first makes return in respect of a property for any taxable year after the taxable year 1933, then in such first return), whether he elects to have the depletion allowance for such property for succeeding taxable years computed with or without reference to percentage depletion. The depletion allowance in respect of such property for all succeeding taxable years shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for succeeding taxable years shall be computed without reference to percentage depletion. During the period for which property acquired after December 31, 1933, is held by the taxpayer—

(A) if the basis of the property in the hands of the taxpayer is, under section 113(a), determined by reference to the basis in the hands of the transferor, doner, or grantor, then the depletion allowance in respect of the property shall be computed with or without reference

to percentage depletion, according to the method of computation which would have been applicable if the transferor, donor, or grantor had continued to hold the property, or

(B) if the basis of the property is, under section 113(a), determined by reference to the basis of other property previously held by the taxpayer, then the depletion allowance in respect of the property shall be computed with or without reference to percentage depletion, according to the method of computation which would have been applicable in respect of the property previously held if the taxpayer had continued to hold such property.

Treasury Regulations 77

(Released February 10, 1933)

ART. 221. Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.— * * *

* * * * *

When used in these articles (221–248) covering depletion and depreciation—

* * * * *

(g) "Gross income from the property" as used in section 114(b) (3) and (4) and articles 221 to 248, inclusive, means the amount for which the taxpayer sells (a) the crude mineral product of the property or (b) the product derived therefrom, not to exceed in the case of (a) the representative market or field price (as of the date of sale) of crude mineral product of like kind and grade before transportation from the immediate vicinity of the mine or well, or in the case of (b) the representative market or field price (as of the date of sale) of a product of like kind and grade from which the product sold was derived, before the application of any processes (to which the crude mineral product may have been subjected after emerging

from the mine or well) with the exception of those listed below, and before transportation from the place where the last of the processes listed below was applied. Where there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes minus the costs (including transportation costs) of the processes not listed below. The processes excepted are as follows:

(1) In the case of coal—cleaning, breaking, sizing, and loading at the mine for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading at the mine for shipment;

(3) In the case of iron ore and ores which are customarily sold in the form of the crude mineral product—sorting or concentrating to bring to shipping grade, and loading at the mine for shipment; and

(4) In the case of lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product—crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined product on the other) than crushing and concentrating (by gravity or flotation).

In all cases there shall be excluded in determining the "gross income from the property" an amount equal to any rents or royalties which were paid or incurred by the taxpayer in respect of the property and are not otherwise excluded from the "gross income from the property." Where royalties in the form of bonus payments or advanced royalties (see article 230) have been paid in respect of the property in the taxable

year or in prior years, the amount excluded from "gross income from the property" for the taxable year on account of such payments shall be an amount equal to that part of such payments which is allocable to the *products* sold during the taxable year. [Italics supplied.]

(h) "Net income of the taxpayer (computed without allowance for depletion) from the property," as used in section 114(b) (2), (3), and (4) and articles 221 to 248, inclusive, means the "gross income from the property" as defined in paragraph (g) less the allowable deductions attributable to the mineral property upon which the depletion is claimed and the allowable deductions attributable to the processes listed in paragraph (g) in so far as they relate to the product of such property, including overhead and operating expenses, development costs properly charged to expense, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. Deductions not directly attributable to particular properties or processes shall be fairly allocated. To illustrate: In cases where the taxpayer engages in activities in addition to mineral extraction and to the processes listed in paragraph (g), deductions for depreciation, taxes, general expenses, and overhead, which can not be directly attributed to any specific activity, shall be fairly apportioned between (1) the mineral extraction and the processes listed in paragraph (g) and (2) the additional activities, taking into account the ratio which the operating expenses directly attributable to the mineral extraction and the processes listed in paragraph (g) bear to the operating expenses directly attributable to the additional activities. Where more than one mineral property is involved, the deductions apportioned to the mineral extraction and the processes listed in paragraph (g) shall, in turn, be fairly

apportioned to the several properties, taking into account their relative production.

(i) "Crude mineral product," as used in paragraphs (g) and (h) of this article, means the product in the form in which it emerges from the mine or well.

1934

[In its proposals for the Revenue Act of 1934, c. 277, 48 Stat. 680, the Treasury Department recommended elimination of discovery and percentage depletion. Representatives of the mining industry appeared before the House Ways and Means Committee in opposition to these proposals. Illustrative portions of their testimony follow.]

House Hearings, 1934

(Revenue Revision, 1934, Hearings before the Committee on Ways and Means, House of Representatives, 73d Cong., 2d Sess.)

[266] Statement of LOUIS C. GRATON, Cambridge, Mass., representing the Cerro de Pasco Copper Corporation:

* * * * *

[271] Beyond what I have already said, the arguments in favor of percentage depletion when properly determined are so numerous and voluminous as to make at once impossible and improper their complete inclusion before your committee assembled in session. Furthermore, they inevitably involve many considerations of a specialized technical nature, adequate illumination of which would entail extended explanation and long chains of close reasoning that would be difficult to follow in oral presentation. *The entire subject has been very fully covered, however, in official documents, notably the "Preliminary Re-*

port on Depletion", submitted in 1929 to the Joint Committee on Internal Revenue Taxation by its technical staff under the direction of Mr. L. H. Parker; and, second, the fuller record entitled "Depletion of Mines", presented at the hearings before the joint committee in 1930. If permissible, I should like to submit also an article entitled "Percentage depletion for mines", presented before the American Mining Congress in 1929, and now marked "Exhibit A." [Italics supplied.]

* * * * *

[392] Statement of DONALD A. CALLAHAN, of Wallace, Idaho, representing the Northwest Mining Association:

The CHAIRMAN. Give your name and address, Mr. Callahan.

Mr. CALLAHAN. My name is Donald A. Callahan. My address is Wallace, Idaho.

Mr. Chairman and members of the committee: I am here to represent the Northwest Mining Association, a group of those engaged in the metal-mining industry in the Northwest; and also, as Mr. Fernald has stated, to represent the views generally of the American Mining Congress, particularly with relation to the question of mine depletion as it particularly applies to metal mining.

* * * * *

[393] In 1929 the staff of the Joint Committee on Internal Revenue Taxation presented a preliminary report to this committee, and in that report it used the following language:

* * * * *

Following the submission of this report a hearing was had before the Joint Committee in 1930, and the results and the record of that hearing, of course, are available to the members of this committee.

The principle of percentage depletion had been applied to oil and gas wells in the Revenue Act of 1926, and has been in effect in that industry ever since. In 1932 it was extended to metal mines, sulphur, and coal, the allowance for metal mines being 15 percent of gross. This action was taken by the Congress after a hearing before the Senate Committee on Finance and with all the data contained in the report of the staff of the Joint Committee on Internal Revenue Taxation and of the hearings before that committee available for its consideration. It was a matured and reasoned decision upon the part of Congress. It was a step taken to do away with inequalities that had been manifest in the administration of the law as theretofore existing. That step was also prompted by a desire to do away with high administration costs and to return a more stable revenue to the Government. It was not intended as a subsidy, but as a correction of evils which had grown up under a system that was exceedingly difficult and costly to administer.

* * * * *

[397] Statement of E. T. CUMMINS, representing American Sulphur Producers, Washington, D.C.:

* * * * *

The subject we are interested in has been covered very well by Mr. Fernald and Mr. Callahan, who appeared before the committee this morning; and in order to save time I would just like to ask permission to file a statement in the record.

The CHAIRMAN. Without objection, that may be done.

(The statement referred to follows:)

WASHINGTON, D.C., *December 20, 1933.*

Chairman and Members of the Ways and Means Committee of the House of Representatives.

* * * * *

[398] That the percentage depletion rate which Congress, after the most exhaustive investigation, established for the sulphur industry in the Revenue Act of 1932 is fair and reasonable and should not be disturbed.

In fixing the rates of percentage depletion contained in the Revenue Act of 1932 each branch of the mining industry was made the subject of a separate study. In each case the joint congressional Committee on Internal Revenue Taxation took into account the facts developed over long periods of time. In the course of these investigations the sulphur industry was subjected to a most exhaustive study and as a result of the studies, the committee aforesaid recommended a rate which is regarded as fair and proper to the industry. This rate was adopted and approved by Congress in the Revenue Act of 1932.

In conclusion, the principle of percentage depletion as applied to the sulphur industry rests upon sound economic principles and the rate applied to that industry represents a fair and reasonable allowance. It is, therefore, respectfully submitted that the principle and rate established in the Revenue Act of 1932 be continued.

Respectfully submitted.

FREEPORT SULPHUR CO.,
New York, N.Y.

1936

[Section 114(b)(4) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, merely made a change regarding election of the manner of taking depletion.]

So far as pertinent here, Treasury Regulations 94, promulgated under the 1936 Act, are the same as those promulgated under the 1934 Act except that Article 23(m)–1(3)(g) added the following:

* * * * *

> In the case of oil and gas, if the crude mineral product is not sold on the property but is manufactured or converted into a refined product or is transported from the property prior to the sale, then the "gross income from the property" shall be assumed to be equivalent to the market or field price of the oil or gas before conversion or transportation.

1940

[As in the 1934 and 1936 Acts, the material provisions relating to percentage depletion remained substantially the same in the Revenue Act of 1938, c. 289, 52 Stat. 447, and were adopted in the Internal Revenue Code of 1939. Similarly, the Treasury Regulations remained basically unchanged until January 1940, when the "proportionate profits test" was first introduced by the issuance of T.D. 4960, approved January 3, 1940 (1940–1 Cum. Bull. 38), amending Treasury Regulations 101, which had been made applicable to the Internal Revenue Code of 1939 by T.D. 4885 (1939–1 Cum. Bull. (Part 1) 396). As contained in Treasury Regulations 103, issued in 1940, the pertinent sections are given below.]

Treasury Regulations 103 (1940 ed.)

(Promulgated under the Internal Revenue Code of 1939)

SEC. 19.23(m)–1. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*—Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other

natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

The adjusted basis of depreciable property is returnable through annual depreciation deductions. Depreciation and depletion deductions on the property of a corporation are allowed to the corporation and not to its shareholders. (But see section 19.115–6.) The principles governing the apportionment of depreciation in the case of property held by one person for life with remainder to another person and in the case of property held in trust are also applicable to depletion. (See section 19.23(l)–1.)

When used in these sections (19.23(m)–1 to 19.23 (m)–28, inclusive) covering depletion and depreciation—

(a) The "fair market value" of a property is that amount which would induce a willing seller to sell and a willing buyer to purchase.

(b) A "mineral property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface of the land only as is necessary for purposes of mineral extraction. The value of a mineral property is the combined value of its component parts.

(c) The term "mineral deposit" refers to minerals in place. The cost of a mineral deposit is that proportion of the total cost of the mineral property which the value of the deposit bears to the value of the property at the time of its purchase.

(d) "Minerals" include ores of the metals, coal, oil, gas, and such nonmetallic substances as abrasives, asbestos, asphaltum, barytes, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth, graphite, gravel, gypsum, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, sulphur, and talc.

(e) The term "mine" does not include oil and gas wells.

(f) "Gross income from the property," as used in section 114(b) (3) and (4) and sections 19.23(m)-1 to 19.23(m)-28, inclusive, means the amount for which the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine or well, but, if the product is transported or processed (other than by the processes excepted below) before sale, it means the representative market or field price (as of the date of sale) of crude mineral product of like kind and grade before such transportation or processing. If there is no such representative market or field price (as of the date of sale), then there

shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation and the processes not listed below. The processes excepted are as follows:

(1) In the case of coal—cleaning, breaking, sizing, and loading at the mine for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading at the mine for shipment;

(3) In the case of iron ore and ores which are customarily sold in the form of the crude mineral product—sorting or concentrating to bring to shipping grade, and loading at the mine for shipment; and

(4) In the case of lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product—crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined product on the other) than crushing and concentrating (by gravity or flotation).

In case any of the excepted processes are not applied in the immediate vicinity of the mining district in which the mine is located, costs incurred for transportaton to the processing location and, if transported by taxpayer, the proportionate profits attributable to transportation should be subtracted from the sale price of the product to determine "gross income from the property."

In the case of oil and gas, if the crude mineral product is not sold on the property but is manufac-

tured or converted into a refined product or is transported from the property prior to the sale, then the "gross income from the property" shall be assumed to be equivalent to the market or field price of the oil or gas before conversion or transportation.

* * * * *

(g) "Net income of the taxpayer (computed without allowance for depletion) from the property," as used in section 114(b) (2), (3), and (4) and sections 19.23(m)-1 to 19.23(m)-28, inclusive, means the "gross income from the property" as defined in paragraph (f) of this section less the allowable deductions attributable to the mineral property upon which the depletion is claimed and the allowable deductions attributable to the processes listed in paragraph (f) in so far as they relate to the product of such property, including overhead and operating expenses, development costs properly charged to expense, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. Deductions not directly attributable to particular properties or processes shall be fairly allocated. To illustrate: In cases where the taxpayer engages in activities in addition to mineral extraction and to the processes listed in paragraph (f), deductions for depreciation, taxes, general expenses, and overhead, which cannot be directly attributed to any specific activity, shall be fairly apportioned between (1) the mineral extraction and the processes listed in paragraph (f) and (2) the additional activities, taking into account the ratio which the operating expenses directly attributable to the mineral extraction and the processes listed in paragraph (f) bear to the operating expenses directly attributable to the additional activities. If more than one mineral property is involved, the deductions apportioned to the mineral extraction and

the processes listed in paragraph (f) shall, in turn, be fairly apportioned to the several properties, taking into account their relative production.

(h) "Crude mineral product," as used in paragraph (f) of this section, means the product in the form in which it emerges from the mine or well.

* * * * *

1942

[In the Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 145, fluorspar, ball and sagger clay, and rock asphalt were granted a 15 percent depletion allowance. Through its representatives, the mining industry appeared before the Ways and Means Committee, the Senate Finance Committee and a subcommittee of the Senate Special Committee on the Investigation of Silver where various problems, including the definition of gross income from the property and the propriety of the "proportionate profits test", were discussed. Pertinent extracts from these hearings, the Committee reports, Congressional debates, and the Act as passed are printed below in chronological order.]

House Hearings, 1942

(Revenue Revision of 1942, Hearings before the Committee on Ways and Means, House of Representatives, 77th Cong., 2d Sess.)

[1168] Statement of DONALD A. CALLAHAN, Wallace, Idaho, vice president, American Mining Congress:

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[1169] Mr. CALLAHAN. * * *

Another thing that enters into the production of metals is that in the gross price that is finally paid for the metals there is included so much for elements of the cost that do not enter into the matter of oil and gas. Those are included in the price that is eventually

[1170] received for the metals. That accounts for the difference in the percentage.

As a matter of fact, *this whole matter of percentage depletion was so thoroughly reviewed by the Joint Committee on Internal Revenue Taxation and by the committees when percentage depletion was extended to mines that I can do nothing better than refer you to the report, which I see you have had reprinted; and that is the report of the staff of the Joint Committee on Internal Revenue Taxation, made before this allowance of percentage depletion for mines was written into the law.* [Italics supplied.]

It was upon this largely that the committees of Congress acted in doing away with discovery depletion as it related to mines, and substituted therefor the method of depletion according to this percentage. [Italics supplied.]

They arrived at that percentage by taking the average of the depletion allowance under the old method hitherto in vogue and which had been used from the very beginning, taking the weighted average over a 5-year period, and finding that that amounted for metal mines to a little better than 17 per cent of the net smelter return, which was the selling price of the ore. They also found that that amounted to approximately 33⅓ per cent of the net, which was the rate then employed in Canada.

The rate of 15 per cent was agreed upon more or less as a compromise, which was less than the average rate that had been paid over that weighted period, and which amounted to approximately 30 percent of the net value.

* * * * *

[1182] I have here certain memoranda in regard to this percentage depletion of mines which I would like

to file for the record. They illustrate certain points that I have brought out.

* * * * *

The CHAIRMAN. Without objection, that may be filed.

(The memoranda referred to are as follows:)

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[1184]

PERCENTAGE DEPLETION—THE POSITION OF THE MINING INDUSTRY

By the American Mining Congress, Washington, D.C., March 1942

The Secretary of the Treasury and the special tax adviser to the Treasury have made certain statements and advanced certain recommendations to the Ways and Means Committee of the House of Representatives touching the allowances for depletion in case of metal mines. These statements and recommendations may be briefly summarized as follows:

* * * * *

We summarize the position of the mining industry briefly as follows:

1. *Depletion is a return to the mining industry of the capital consumed in its operations.*—The mineral in place in the ground is the principal capital of every mineral producer. As each ton is extracted, a certain portion of his capital is actually consumed. A portion of his proceeds from each ton is the return of his capital, and only a portion is income. Since the inception of the income tax, every effort has been made to tax income only and to avoid taxing capital. Depletion is merely the method by which the return of capital is computed. The right to a return of capital has always been recognized. This right has never been seriously questioned. It is not questioned by the Secretary at this time.

2. *The present system of computing depletion resulted from careful study and affords the best means for determining the annual consumption of capital.*—After years of experience with other methods of computing depletion, the Congress in 1932 included the present percentage method for metal mining, coal, and sulfur. This was upon the recommendation of the staff of the Joint Committee on Internal Revenue Taxation, which made an exhaustive study of the subject. The Joint Committee held extensive hearings, and the printed reports of the staff of the Joint Committee and of the hearings before the committee were considered by the Congress in the adoption of the percentage method and in fixing the rates. The rates so fixed were lower than the average rates actually allowed under the previous laws.

3. *The percentage method furnishes both uniformity and certainty in computing depletion.*—The report of the staff of the Joint Committee called special attention to the uncertainty and lack of uniformity under the methods of computing depletion which theretofore had been the only methods allowed. Tables were given showing the wide difference in allowances of depletion between [1185] different branches of the industry and individual taxpayers. The inclusion of the percentage method has remedied this situation.

* * * * *

5. *Percentage depletion provides more equal treatment to those engaged in the industry.*—One of the objects sought to be attained by the percentage method was the elimination of the inequality which had existed as between competing members of the mining industry. Under the methods in use prior to 1932, certain companies had been able to establish adequate depletion allowances which, by reason particularly

of the geological nature of their deposits, were not available under the statue to others. The present law tends to remove this inequality and to give all mining taxpayers some measure of protection against taxation of their capital.

* * * * *

7. *Percentage depletion protects the small operator.*—The small mine operator cannot afford to spend the money necessary to establish the value of his mineral deposits and the corresponding depletion value of his unit of production. Percentage depletion removes the necessity for such expenditures. It provides a simple, understandable method by which, from the inception of his enterprise, he may receive the reasonable allowance for depletion contemplated by the statute. It assures him fair and equal treatment with other operators. It protects him against the taxation of the capital he has consumed in his operation.

[1196] * * * * *

Statement of ROBERT M. SEARLS, San Francisco, Calif., representing California Chapter of the American Mining Congress.

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[1199] *I may go one step further and point out to the committee that the Treasury, in the opinion of the mining industry, has not fairly interpreted the intent of Congress in administering the existing law.* The existing law, section 114(b)(4), provides for an allowance of 15 percent of "the gross income from the property during the taxable year" excluding rents and royalties with a further proviso that this 15 percent shall not exceed 50 percent of the net income computed without allowance for depletion. *In view of the fact that the gross income of mineral properties has always been considered as the price at which the metals produced can be sold, we submit*

that it was obviously the intent of Congress that the net mint or smelter value of metals, less possibly the cost of transportation, should be considered as the true gross income of the properties whether these metals are sold in metallic form or in the form of concentrates which are valued solely on the basis of their metal content. The Treasury however has taken the position that the gross income is to be based on what they term "the first marketable product" and if the mine owner instead of erecting a smelter or cyanide plant should sell his metal concentrates to a smelter on the basis of the metal content then, so the Treasury says, the gross income from the property is simply the market value of the concentrates. Then they go a step further, and say that even if the owner has on the property a smelter or cyanide plant by which to extract the metal from the concentrates the cost of so doing plus an assumed profit on the operation must be subtracted from his gross income in computing depletion because if he did not have these facilities he would have to sell the concentrates. *In the case of mercury recently they have gone even further. Cinnabar, the ore from which this metal is produced, has no market as such, and must be beneficiated through roasting in a furnace from which the mercury emerges in vapor is passed into a condenser and emerges in its normal liquid condition. The Treasury proposes to deduct the entire cost of furnacing, for what reason it is not apparent.* [Italics supplied.]

* * * * *

[1202] Recently in the quicksilver mining, where the ore is put directly into the furnace and melted and the quicksilver vapors come off and are condensed and you get the quicksilver without any milling, do we deduct the entire furnace cost on the theory that that is the same kind of processing as cyanide, although the ore from which the metal comes has no market

as such? It has to be transported to market and put up in flasks.

Mr. BUCK. I was somewhat astonished at that statement about quicksilver. After all, the money expended for the production and refining of the cinnabar is a cost, isn't it?

Mr. SEARLS. It is a cost.

Mr. BUCK. Is there any income until it has been refined?

Mr. SEARLS. No, sir; not a dollar, not a dime. And these mines, all of them in California, are 50 or 60 miles from the nearest railroad.

Mr. BUCK. They happen to be in my district.

Mr. SEARLS. Yes; some of them are. One of the oldest and largest of the mines, I think, is in your district.

The cinnabar, as I say, could not possibly be sold. Yet the Treasury, by the Treasury ruling, insists upon deducting a very considerable cost of milling before getting at the gross revenue from the material. [Italics supplied.]

I mention these incidents merely to show that percentage depletion is being applied with very rigid adherence to a technical interpretation, and with the 50 percent limit on your net which comes before the 15 percent.

* * * * *

H. Rep. No. 2333

(77th Cong., 2d Sess. (1942) (1942–2 Cum. Bull. 372))

[63] DETAILED DISCUSSION OF THE TECHNICAL PROVISIONS OF THE BILL

* * * * *

[92] SEC. 131. PERCENTAGE DEPLETION FOR COAL, FLUORSPAR, AND METAL MINES AND SULPHUR

This amendment provides that fluorspar mines are to be allowed percentage depletion at a rate of 15 percent, subject to the same limitations as are applicable in the case of metal mines. For taxable years beginning after December 31, 1941, the depletion deduction for coal, fluorspar, metal, and sulphur mines may be computed (without regard to any election) either on the percentage basis or on the cost basis, whichever gives the greater deduction.

Silver Subcommittee Hearings, 1942

(Silver, Hearings before a Subcommittee of the Special Committee on the Investigation of Silver, United States Senate, 77th Cong., 2d Sess., pursuant to S. Res. 187 (74th Cong.) (part 9))

[731]

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Statement of JULIAN D. CONOVER, Mining Engineer, Secretary of the American Mining Congress, Washington, D.C.:

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[736]

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6. *Depletion.*

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Further, we protest against recent rulings of the Bureau of Internal Revenue tending to curtail the depletion allowances intended by Congress through the Bureau's interpretation of the "gross income from the property," on which the percentage allowance is computed. This adversely affects producers of gold and

silver by the cyanide process, mercury producers, and many others whose ore treatment facilities extend beyond mere crushing and concentration by gravity or flotation methods. I shall not discuss this in detail, but ask your careful consideration of what may be said on the subject.

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[738] Statement of ROY A. HARDY, Consulting Mining Engineer for Getchell Mine, Inc., Humboldt County, Nev.

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[740]

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In the last few years, the Treasury Department has, in practically all instances, taken an opposite position to that which they have followed for the past 15 or 20 years, and, in the case of depletion where the mining operator felt that a certain policy was being followed, he now finds that the Treasury Department is attempting to upset what has been considered to be a definite depletion procedure and is decidedly unsympathetic. [Italics supplied.]

* * * * *

[741]

* * * * *

SENATOR MURDOCK. That is, you are constantly depleting what is the capital of the mining company or the individual. Now, would you say that the smelter or the concentration mill which is operated separately from any mines should be so treated, or should they be in an entirely different category for tax purposes?

Mr. HARDY. That would depend on whether it were for custom work entirely or a particular property.

Senator MURDOCK. I am assuming that they are

erected originally for custom work without any particular relationship at all to any specific mine.

Mr. HARDY. Yes; because they should be depleted with a certain rapidity depending on the area from which they are drawing their ores.

SENATOR MURDOCK. *But if we grant to the mine operators that percentage depletion that is now granted to them, or if we increase it, you still think that the smelter or the custom mill should be entitled to a percentage depletion, is that right?* [Italics supplied.]

Mr. HARDY. I do; yes.

SENATOR MURDOCK. *And then, following this line of question, I assume that you take the position that if you have a mine concentration mill and smelter combined that is all owned by one company, operated by that same company, that the depletion should be fixed as against the gross income of the complete operation. Do I make myself clear?* [Italics supplied.]

Mr. HARDY. *Certainly. The Treasury Department takes the opposite view. They say a profit is derived from a part of the process.* [Italics supplied.]

SENATOR MURDOCK. That is the point I would like to have you discuss. It was brought out this morning by Mr. Conover that the internal revenue people had, in his opinion, as I understood him, misconstrued the law and that at certain point in such an operation they want to draw the line and say this is mining up to this point, and entitled to the percentage depletion, but beyond this step in the complete process they are not entitled to it.

Mr. HARDY. It is just like the rancher raising cattle to sell. He feeds the steer hay. Does the Treasury Department say he should [742] pay a profit on the hay as well as on the sale of the steer after the hay has been fed to the cattle? He only has one profit and that is the sale of the steer at the end. Why not

combine that and pay his profit tax on that steer? It is not part of the process of raising that steer. The same thing holds in the mining industry. It is just part of the making of a salable product.

SENATOR MURDOCK. *It is your position, based on your long mining experience, that if you have that combination of mining and processing that the percentage depletion should be figured against the gross income from the completed product?* [Italics supplied.]

Mr. HARDY. Yes; certainly it is.

SENATOR MURDOCK. *Now, if that is allowed, or if that would be allowed, by the Internal Revenue Bureau instead of cutting it off at a certain place, would you be discriminating against, say, the small operator that merely produces ore from his mine and then sells the raw ore to some custom smelter?* [Italics supplied.]

Mr. HARDY. No; there would be no discrimination because his product has to be in a salable form for him to get his profit. When he sells his ore that is figured in his sales.

SENATOR MURDOCK. *In other words, let's see if you will agree with me in this: It is your opinion, then, based on your long mining experience, that a big operator should not be penalized simply because he is able to combine the mining, milling, and smelter under one corporation?* [Italics supplied.]

Mr. HARDY. He should not be penalized; no.

SENATOR MURDOCK. *And that it is no discrimination against the small operator to treat them both in the same category simply because he is too small and not able to combine the milling and smelting with his mine; is that right?* [Italics supplied.]

Mr. HARDY. That is right; yes.

The CHAIRMAN. Are there any further questions?

Mr. L. P. ANDRESEN. Mr. Hardy, among your recommendations is one that the limitation of percentage depletion which is now provided in the act at 50 percent of the net income from the property, be eliminated?

Mr. HARDY. As a straight percentage depletion granted.

Mr. ANDRESEN. Wouldn't that have the effect of completely relieving the mining operator from all taxation where the depletion allowance was exactly equal to the net income?

Mr. HARDY. Mr. Semenza, could you help me out on that question?

Mr. LAURENCE SEMENZA (certified public accountant, Reno, Nev.)—It would have that effect, Mr. Andresen, if the situation should exist some time.

Mr. ANDRESEN. Would not that relieve the taxpayers at this time of great need for revenue of any liability to pay taxes?

Mr. HARDY. It may, in a specific problem, but I could not see that it would in general. What do you think, Mr. Semenza?

Mr. SEMENZA. I can see in a specific case that it might.

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Statement of ROBERT M. SEARLS, Attorney at Law, San Francisco, Calif.:

My name is Robert M. Searls and I am a practicing lawyer in San Francisco, Calif. I have practiced law for more than 30 years, principally in the realm of mines and oil.

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[760] Very well. Congress said in section 114(b)(4) that with mineral properties that should be 15

percent of the gross income from the property, and personally I am not quarreling about the percentage. * * * But what I am coming to, *what I term the "chiseling" of the original intent of Congress through administrative measure, is this:* Now, section 23 (m) provides that the depletion should be computed according to peculiar conditions in each case under regulations to be prescribed by the Commissioner of Internal Revenue. Then that was modified by section 114, to which I referred before, saying that this percentage in the case of metal mine incomes should be limited to 15 percent, but that is the only extent to which it was modified. Under the authority of that section, the Treasury has promulgated its regulations. Treasury Regulation 103, section 19.23(m), is the one that was apparently most pertinent here. I will read a short excerpt from it, as follows: [Italics supplied.]

* * * * *

Now, I submit that a mineral property has no value at all, with which we are concerned here, except for the metal which it contains. If you are a small operator and sell your concentrates to a smelter instead of producing them yourself or beneficiating the concentrates or not, the valuable product itself is the metal in them. It is true sometimes concentrates are put into a steel furnace with other ores and turned into alloy steels by proper measurement, but it is the metal that is the thing of value, not the rock, sand, gravel, silica, or what not, that gives it the value; it is the metal. *Therefore I say it was the intent of Congress when they said "gross income from the property" meant gross value of the metal from the property.* I say further if they mean gross value, there is no more fair ground for deducting the cost of concentrating, cyaniding, or milling that ore, or even roasting it in the case of quicksilver, than there is for deducting the

cost of mining or extracting the rock from the ground. It is all a part of the process of extracting the metal from the ground; it is a continuous process. If the owner of the ground has no smelter to melt concentrates for him and because of the impossibility of segregating the concentrates in the smelter or refinery, sells it to a smelter and passes the title, he still only gets paid on the basis of net total content less the costs which he himself would incur if he did it himself, and the smelter thereby profits. Now that fact that the smelters may make a profit on it doesn't make any difference. *I don't think I agree with Mr. Hardy for instance, that the smelter should be allowed depletion. I think the mine owner, the fellow that has got the rock in the ground, that is having it taken out and depleting the value of his property, is the only one that can logically be allowed depletion.* The smelter, it is true, may depend for its life upon the life of the mines in the vicinity that it serves, but it should figure its depreciation and obsolescence allowances on its structures, which are the only assets it has. It does not have any mineral deposits; if it has, it should be allowed depletion on those, but it doesn't have assets as a smelter other than physical structure. *I think the depletion should all go to the mine owner whether or not he beneficiates his ore or sends it to a smelter. If you do that you have an absolutely logical position.* [Italics supplied.]

What has happened under these regulations, the Treasury says, "Oh, no; if the mine owner mines the ore and sends men down underground and digs it out, then crushes it, puts it through flotation, obtains concentrates, sells those concentrates to a smelter, he is selling a [762] first mineral product. The first mineral product is not the mineral, but the concentrates. Therefore, anything that tends to beneficiate concen-

trates is something beyond the value of his product and he should only be allowed to claim depletion on the value of the thing he receives less the cost of getting it from the mine bottom to that point." Well, they take the instance of the man who sells to the smelter and they have perhaps a little argument there. Then they come back and say, "Well, if the company itself owns a cyanide plant and refinery we have got there a theoretical computation that they are selling the concentrates to themselves after they get them through the flotation, and subtracting the cost of the cyaniding."

Then, they come to the quicksilver people and that is a very hot argument right now. It deals with a highly strategic metal and they do not have any milling or any cyaniding in the case of quicksilver. The ore produced is cinnabar. It comes out in the form of an ore containing some perhaps 6 pounds to 20 pounds of mercury to the ton. That means if it is sold in flasks of 75 pounds of metal, you would have to transport from 4 to 12 tons of ore to get one flask of metal, and that is just out of the question as an operative proposition. Well, the ore goes from the mine through a primary crusher into a rotating furnace and is roasted. The Treasury says that is just like a smelter, you roast it, therefore that cost is out. From the rotating furnace it goes into a condenser and the liquid metal itself comes out of the condenser. There is no intermediate process. Now they have not in this regulation even mentioned quicksilver; they tried to draw an analogy to other ores and say because we deduct the cost of roasting copper, lead, or zinc ores, before arriving at "gross income" therefore we are going to deduct the cost of roasting quicksilver *although it is essential, in order to get any marketable product, that this roasting be*

done at the mine. That shows where the lack of logic in their whole position leads. I am going to come to a suggested remedy in a few minutes. [Italics supplied.]

They pass from one step to another, subtracting first the cost of roasting the concentrate where they go to a smelter. They say they have been sold to the smelter or the refinery, then. If you do that you must charge the owner who has his own smelter or refinery the same if you are going to deduct the cost of roasting so as not to discriminate in favor of the big fellows. *There is no more reason for deducting the cost of cyaniding, then, because the regulations don't say anything else, than there is for a deduction of the roasting cost.* Then they come back to mercury, which is not similar, and deduct what is tantamount to the entire milling cost in getting at the gross income from the land on which depletion is to be computed. The next thing, of course, if they are logical, will be to say, after all cyaniding is a considerable part of the cost of getting the metal out, and so is milling. "Let's take the milling cost out;" and then, after they have done that they might as well say: "We will disallow the extraction expenses, mining and everything else, because that is part of the cost of getting the metal out," and then you will be allowed 15 percent, not of the gross income from your property, but of the net income. Congress says, the law passed by Congress says that you may have 15 percent of the gross up to 50 percent of the net. Logically carried out the present course of action of the Treasury leads to just that at third conclusion, and it distorts the intent of Congress and removes all of the benefits of the depletion allowance from the owners. [Italics supplied.]

[763] Now, what remedy can be found for this? I told your committee at the beginning that I did not

suggest any amendment of the sections dealing with percentage depletion. I think if you take section 23 under the act, persuade your Senate Ways and Means Committee to insert a simple definition of gross income from the land as being the gross value of the metal derived from that land, allow the owner of the land to take a 15 percent of it, limit him to 50 percent of the net, then the thing would be simple of administration and a lot of this temptation to chisel which the present regulations give would be wiped out by the act of Congress itself. I think the original intent of Congress, which was to allow the mine owner to deduct depletion for that which he was wasting and losing and operating as property would be carried out, and the Government would not lose by the operation, particularly as the additional certainty and security which this would give mine operators would tend to encourage the development of new bodies of strategic minerals which are very much desired today. Thank you, gentlemen.

The CHAIRMAN. Are there any questions?

Mr. HARDY. *I wish to make a statement to the effect that I thoroughly concur with Mr. Searl's idea of depletion on a custom plant, but I do think there are certain circumstances whereby if a custom plant is built to treat ore in a certain restricted area, a certain amount of ore, they may be entitled, the case might have some merit of depleting, but such plants always have the depreciation to fall back on anyway.* [Italics supplied.]

Mr. ANDRESEN. You spoke from time to time about the chiseling attitude of the Bureau in this matter.

Mr. SEARLS. I did not mean that in a disrespectful tone, Mr. Andresen. I used it as we commonly use it. I think you have been whittling down what was orig-

inally intended as an equitable allowance to mine operators—I call it chiseling for short.

Mr. ANDRESEN. To preface the question, I would like to outline a case to you. Basically we have the conception we should treat all taxpayers alike. I think you will agree that we have tried to do that. The act which speaks in terms of mines, oil and gas, and gas wells, timber, and other natural deposits, never speaks of smelters, manufacturing plants, marketing systems, or transportation systems. Early in the days of percentage depletion oil and gas companies took the product of the well, put it through a plant and produced gasoline, and then said to us, "There is the first marketable product." This is what Congress intended percentage depletion should apply to. The Court settled it in the case of *Signal Gasoline Corporation* v. *Commissioner,* 77 Fed. (2d) 728, and held that Congress intended that the percentage depletion should apply to the price at which the product would have sold at the mouth of the mine or well and not to the price for which the refined product was sold.

In the committee hearings, it was made clear that the basis of gross income for the property was to be net smelter returns to the operator of the mine; in other words, depletion relates to the price he could get for the concentrates from a smelter, assuming that the smelter would get a reasonable profit for the investment in addition to its depreciation and costs. We then found ourselves face to face with taxpayers who own mines, smelters, refineries, and marketing systems. These [764] taxpayers contended they should have depletion based on the sale of the refined product—the metal. If we had allowed that, it would have provided them with a substantially greater depletion allowance than the miner would

have, who only owns a mine and a mill. That matter has been pending before the United States Board of Tax Appeals for some years now. In a comparative situation taxpayers who owned producing properties, pipe lines, transportation systems, and distribution systems in a city contended that the only marketable product produced was the gas sold to the consumer and used in the house, and that the Congress intended that the percentage depletion should apply to the ultimate selling price of the product. The United States courts decided two cases holding that the percentage depletion would have to be computed on the price for which they would have sold the gas at the well (*Consumers Natural Gas Co.* v. *Com.*, 78 Fed. (2d) 161; *Greensboro Gas Co.* v. *Com.*, 79 Fed. (2d) 701). *What the mine owner would have sold the ore for in the form of a concentrate at the mine provides the gross income from the mining property for percentage depletion purposes. When he beneficiates the product in greater degree, we must deduct from the selling price the costs of other processes such as smelting, roasting, refining, selling, and the proportionate profits attributable to those, to arrive at gross income from the mining property.* Don't you think that this is basically fair to taxpayers and puts them all on the same basis? [Italics supplied.]

Mr. SEARLS. No, sir; I do not for this reason: In the case of oil and gas wells you have produced *a product which is marketable,* a product with many uses and many possibilities as it comes out of the well, also there is a field price for crude oil dependent on market—a field price for gas if there is any market for it at all. There you have an ultimate product upon which refining operates to reduce it into further constituent elements which may be the gasoline, hydrocarbons, various grades of kerosene distillage,

fuel oil, finally winding up in asphalt. ***Obviously it was not the intent of Congress that those processes which would take your products and make them into different products having very different uses should be considered, as the basis of depletion.*** But I say in respect to metals that that is not true because the thing that comes out of the mine in the first place is just ore; 90 percent of it is waste unless it is high grade, and it has not any market value at all. That certainly is true in the quicksilver case, the quicksilver mines are before your committee now, and it is equally true of practically all mines. Maybe a few high grade gold ores could be sold and stand the cost of transportation, but very few. Now you come to concentrates; it is the same thing. It is true that a man may employ a smelter to do the concentrating, he may even transfer title of the concentrates to the smelter. What you get out of it is not a market price for the concentrates. He gets the value of the metal less the cost of treating concentrates, and it is a very different situation than the oil wells, and I don't think that the cases which you mention, with which I am very familiar, have any proper bearing on the situation when it comes to distinguishing between the mine owner who owns his own mill, refinery, smelter or cyanide plant, and the fellow who doesn't own it. I see no reason for giving the big fellow that has all those big works any better or any worse deal than the little fellow who hasn't got them. I say that the refining process has nothing to do with the depletion. [Italics supplied.]

[765] Mr. ANDRESEN. To test out your theory, I know of an actual case. I will not name the taxpayer. This taxpayer owns a mine, owns a railroad, a large smelter, and an electric refinery and a shipping and marketing system which sells copper all

over the world on a world market. In that case an attempt was made to compute the gross income from the property reducing the selling price of the metal by the cost of the selling, or marketing, the cost of refining, the cost of smelting, the cost of railroad transportation.

Mr. SEARLS. That was to comply with your regulation, wasn't it?

Mr. ANDRESEN. No; it was not. It had the effect of putting all of the profit in the mine.

Mr. SEARLS. Yes; I think——

Mr. ANDRESEN. Do you think it belongs there? Why would people build smelters if all of the profit is in mining?

Mr. SEARLS. A man who owns the mine doesn't want to build a smelter, so he gives some of his profit to somebody else. That is all right.

Mr. ANDRESEN. If he does, why should a manufacturing company or a smelting and refining company be entitled to depletion when its full investment can be recovered from depreciation?

Mr. SEARLS. It should not, *but it should be allowed depletion on the metal value in properties from which metal is mined without subtraction for the cost of concentration on the theory that a gross return from the property is the value of the metal in it. It is not its "gross income," but it is "gross income through the property."* [Italics supplied.]

Mr. ANDRESEN. One more question. Take two identical mining properties, in one instance in which the miner produces a concentrate, and in the other instance builds a smelter and goes all the way through refining to the metal. Wouldn't your proposal give substantially more depletion to the one who manufactures the finished product?

Mr. SEARLES. No.

Mr. ANDRESEN. Fifteen percent of a greatly augmented selling price?

Mr. SEARLS. No, sir; in a gold operation the price of the metal is $35 an ounce, fixed by law. No producer would get $35 an ounce for the metal if he shipped the concentrates extracted to a refinery.

Mr. ANDRESEN. That makes a substantial difference.

Mr. SEARLS. I cannot see that; if he elects to invest his capital in the erection of the refinery, well and good, but the thing that is of value in the refined product is the metal and the ultimate value of that metal is the thing I think on which Congress intended depletion to be computed. If it is computed on that value, all your troubles are going to disappear.

Mr. CAMPBELL. This is a technical question we are on. In all probability it is a subject which will be adjudicated by the courts. I should like to ask Mr. Searls, if I may, what bearing that has on the curtailment of production. Can he cite cases in which this situation is holding up the efforts of the War Production Board in trying to get metal output?

Mr. SEARLS. I cited two cases, one dealing with chrome, the other with copper operations, both of which are strategic metals in which the attitude of the Treasury on depletion as well as the excess profits tax were sufficiently determined to prevent further production. I [766] cannot separate the exact weight of the two upon the proposed investors, but they are both operating.

Mr. CAMPBELL. Was the question of depletion you are discussing now, the attitude regarding the allowance of percentage depletion?

Mr. SEARLS. The Treasury interpretation on the depletion act. I don't think that the taxpayers would have been bothered by 15 percent of the gross at all if the gross had not been whittled down to a point

where it is going to be negligible. To illustrate that, suppose a man had a property on which he sold the concentrates and made a profit, say, of 50 percent on the gross, and then the Treasury comes back and deducts a lot of these things and allocates a proportion of his profit to each of the corporations which he used in getting these concentrates, equal to the profit he made on the whole operation. Eventually he would wind up with practically no income at all because if he made a large profit and the Treasury insisted on apportioning each of these operations which it subtracts from the gross income, by the time you have done that, theoretical profits on milling, cyaniding, and other things added to the actual cost, you will find practically all of your gross income is used up in deductions for theoretical profits. Now, by my mind it is ridiculous.

The CHAIRMAN. Gentlemen, we thank you both for the colloquy. I think it was enlightening. While getting the enlightenment we are being entertained as well.

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Statement of Alex F. Ross, Mining Engineer, Superintendent of the Argonaut Mining Co., Jackson, Calif.:

Mr. Ross. My name is Alex F. Ross, superintendent of the Argonaut Mining Co., of Jackson, Calif. As my good friend McBoyle said yesterday, I am not a taxation expert, although I have done a lot of hard-rock mining, and I call myself a soft-ground miner. [813] At the Argonaut we were producing 8,000 tons of ore; our explosives cost less than $1,000, but out timber cost between four and five thousand dollars, which is an aside to show the character of our work.

When I got notice of this meeting I was told by the secretary of our company I had better come up here. Jackson is only 140 miles away from here.

This word, "beneficiation," kind of stuck in my craw. I can understand how a coal mine can bring coal out of the ground, take out the slate and the wood and other things like that, and crush it and grade it so that it can be used for domestic purposes. I can see where beneficiation can apply to that. I can also see where beneficiation could apply to taking iron out of a mine where some waste materials are probably in that iron ore and what you are after is that iron, just like in a coal mine, what you are after is the coal, but when it comes to these strategic metals, and although I may differ with some of these, they find strategic metals, I think gold is the most strategic metal of all. Sooner or later this war has to be paid for and it has got to be paid for by gold. *I was very glad to hear Mr. Searls' remarks yesterday. If I had written his brief for him, whether I could or not, I doubt whether I would have said anything different from what he said. In other words, he said exactly what I feel about this whole thing.* There is no such a thing as beneficiation in gold ores. That will apply to strategic ores, too. *What we are after is the mineral in those ores.* Now, for the sake of argument if we can bring ore out of our shaft that goes $10 a ton at the door at the shaft, after we get through our different processes it is only worth $9.40, all we can make is a 94-percent ratio. Now, we have a ball mill and cyanidation process for taking out the gold because we have considerable free gold in our ore, high-grade sulphates; *now then, when you fix the cyanidation as being something entirely different from these other things, it seems to me you are putting the wagon in front of the donkey.* Cyanidation is something that came into use in the second

decade of the century, flotation was practically not used until the third, and fourth, and it is only lately, before this war started, that flotation has become a part of our metallurgical processes. *When you are picking out cyanidation to find a flaw with, I don't see why you can't go back and pick out flotation, and finally our ball mill, and also, if you want to, the rock crusher.* The thing leads from naught into absurdity. There is such a thing as beneficiation for ores within coal and iron and things where you are going to sell the product that comes out of the ground, and are doing something to make that produce more valuable. In the gold and other strategic metals what you are after is the mineral in the ore, and the ore, when you get the mineral out of it, you put out in a dump pile and tailing pile or some place like that. [Italics supplied.]

Just in closing, gold mining has so many quirks that no new ones should be added. Even *this cyanidation item* would only make a little bit of difference to some of our gold miners; you know, gold has its value set by the Government and all of the increased costs put on gold mining cannot be passed on to a consumer, and to a large extent that is also true of our silver mining where silver is set by Government price. Those are the things you want to remember. There is no such thing as beneficiation of gold ores, and most of the strategic mineral [814] ores in the sense that you can improve the product after it comes out of the ground and make it more valuable. All you can do to it is to make it less. There is also a tailing loss on every operation. Thank you. [Italics supplied.]

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Statement of S. H. Williston, President, Oregon Mining Association:

Mr. WILLISTON. Senator McCarran, Senator Murdock, and Governor Maw: Though I was at the Reno hearing I did not hear the first part of your Reno meeting. I gave one or two examples there which were, I believe, pertinent. Since then there is another example which is quite pertinent to this inquiry.

This example has to do with the depletion allowance. In the bill the depletion allowance provides for a 15 percent of the gross not to exceed 50 percent of the net of the gross proceeds from the mining property. *A miner understands that as what he gets for his product. The Treasury Department does not necessarily understand it the same way.* They have made a ruling which has this effect, not upon copper, or lead or zinc, but it has this effect upon gold or mercury, tungsten, and probably on chromium. *The Treasury's ruling, as I understand it, and I hope I am right, I may be wrong, is that if the ore is beneficiated that the character of the ore is not changed, then the gross proceeds from that concentrate is the basis for the depletion allowance. If, on the other hand, the chemical conditions of that ore have changed, then that process, the cost and the profit assigned to it, must be deducted, and the gross receipts may be much less.* Now, it is that particular point on which I would like to give some examples from the quicksilver industry which are applicable in a way to gold, and, I think, are quite applicable to some tungsten properties, and possibly to the chrome. [Italics supplied.]

In the recovery of quicksilver the ore ordinarily is crushed and goes into a furnace. In the furnace it is changed from mercury sulfide through oxidation to mercury vapor and sulfur dioxide. It does not

come under the Treasury's ruling. Consequently the basis for depletion in a mercury mine is the ore at the crusher. Now, the ore at the crusher could not be given away. Without going through the furnace the value is far less than the freight on it to the nearest railroad. Now, it so happens that it would be perfectly feasible to use a flotation scheme instead of furnacing, and flotation would probably be about 5 percent less efficient because there would be a double loss, first, from the flotation and, second, from the retorting of the concentrate, but it has not been done in the past that way, and the net result is that the quicksilver mines, instead of getting a 15 percent [859] depletion rate, gets depending on the relative cost of the mining and milling, a 5 perecnt depletion, a 7½ percent depletion, or a 10 percent depletion and possibly in some cases a 12½ percent depletion. In a case where it is an underground mine and the cost of mining, we will say, is 2 to the cost of furnacing, which is 1, then the deletion rate would roughly approximate 10 percent because there are 2 parts in the expenses in mining, 1 part is in furnacing. In other words, the high cost underground mine gets its higher rate. If, on the other hand, it should be an open-pit proposition, where the mining expenses are low and the furnacing costs in comparison are high, the ratio might easily be 3 to 1. In the other connection then, one-fourth of the 15 percent, or about 4 percent, would be the basis for depletion, and 12 percent would not be allowed. Now, when the ruling of the Treasury was passed, I think this dates back a good many years, quicksilver was not considered to be valuable, nobody paid any attention to it. The industry was so small that it did not make any difference. It has only been, as I understand it, within the last few years that this has been progressively applied

to the quicksilver industry. Now, that effect on the quicksilver industry might be overcome by an appeal for special provisions or some such thing to the Treasury Department. However, all of the quicksilver companies are small, comparatively, and they cannot, the individual corporations, justify their existence by the expense of the lawsuit. In other words, it is better to pay "through the nose" or it has been in the past.

Now, that depletion basis is almost the only basis on which a mine can recover its investment. Returned profits are more or less ruled out, so if you cannot recover your investment on the depletion basis you cannot get it. If, instead of the 15 percent which most miners expect, we get 4 percent which as lawyers we are allowed, we cannot do much with it.

Now, the effect of that on gold is probably understood fairly well. If you use a flotation system or if you use gravitational methods then the gross value of your product is the base for your depletion. If, on the other hand, you use cyanide you change the character of the gold, you dissolve it and you get it out in a different form, and the cost of that is not permitted.

Insofar as tungsten is concerned, I believe some of the tungsten properties in Nevada are starting with scheelite, dissolving it and making artificial scheelite in a third process. They have changed it and wound up with a product which is practically the same, but not exactly the same. If the Treasury Department should take that literally, then all tungsten beneficiation of that type would not be allowed and a tungsten mine would deplete not on a 15 percent basis but on a 5 percent which is a comparatively expensive process.

If you jump to chrome, there again the Treasury regulations say flotation or gravitational methods some of the new chrome plants in Oregon are using or expect to use, electrostatic separation of the chrome beach sands, that is not included, but since the chemical change is not made there it would probably get by. If, on the other hand, they pursue the process and put in a roasting plan with SO_2 to change the chrome iron ratio they will be penalized for bringing up the grade by losing a portion of depletion allowance.

[860] The two examples I have in mind are two mercury properties, one in Nevada and one in Oregon. One is an underground mine. The ratio of costs of the two is about $2 mining versus $1 for furnacing. That mercury mine under the present plan could be entitled to approximately a 10 percent depletion basis percentage. The Nevada property, on the other hand, has a relation of probably 3 to 1 in the other way. The expense is largely of furnacing and very slight expense is in the mining. It is going to be reduced to a 3 percent depletion base. That particular property, as it so happens, was started the year that the Senate gave the strategic metals exemption from excess-profits taxation. It was completed in a year in which we got taxed and it is just tuned up and going in a year in which it will get the trousers kicked out of it. It will not last out an appreciable amount of time, probably 1 year. In Reno I was considering that a 15 percent depletion might possibly let that property break even. If it is only to get a 5 percent depletion it cannot possibly break even because it has no previous earnings, and an investment of $200,000 which might give back $8,000. The 10 percent of the excess profits would be very small, and the 5 percent depletion even on half a million dollars gross would not come anywhere close to being of any help.

Senator MURDOCK. May I ask this question: Would it be a fair construction of your statement to say notwithstanding the fact that the Congress intended to give mines a percentage depletion of 15 percent under the rules and regulations promulgated by the Treasury that is cut down to as low as 5 percent?

Mr. WILLISTON. I can see how it might be. That is the way I understand it. If I am wrong I would be only too glad to hear it.

Senator MURDOCK. I think you know much more about it than I do. I think that would be a fair conception of your statement.

Mr. WILLISTON. That is exactly what I say. It is possible to get it down, not possibly as low as three, but certainly as low as five. It is bedded on the technicality. *There are reasons in certain instances for making provisions like that. You might take, for instance, a copper mine, or an iron mine, it would be better to take an iron, for instance, where you mine the ore, you haul it to the smelter, you turn it into pig iron, haul it so much, you turn it into steel, and you base depletion for the mine on the value of the steel rolled into finished shapes.* [Italics supplied.]

SENATOR MURDOCK. *Would you consider that a fair construction of the 15 percent depletion?* [Italics supplied.]

Mr. WILLISTON. *No;* that is the basis, I understand, that the Treasury did not like to grant it on and started from there back, made an artificial cost, or ruling if the character of the ore has changed then we cannot allow anything. Maybe it is applicable in an iron mine, I am not familiar with the iron business, but when it comes to a process of recovery of the metal which is located at the mine and which you cannot sell as the product I think the ruling is somewhat arbitrary and certainly it is going to have

a disastrous effect on any operation which is governed by that ruling. You might say that now, before you put in a quicksilver plant, you should consult with your attorney whether the plant should have flotation or furnacing, because it is really up to the attorney's decision and not the metallurgist as to which one to follow. [Italics supplied.]

[861] Senator MURDOCK. The attorney might be wrong, too, and ruled out by the tax collector.

Mr. WILLISTON. Well, it is out of hand for the metallurgist. In other words, it requires a technical decision as a tax expert and not a metallurgical decision.

SENATOR MURDOCK. *Now, take the Utah Copper out here which produces a low-grade ore. I doubt that their ores are salable to anyone after it is mined, but it must go on through the concentration process before they would have anything to sell. Isn't that true?* [Italics supplied.]

Mr. WILLISTON. *That is true, and inasmuch as it is flotation that, according to the Treasury rules, is permissible, but if they had a chemical process then I doubt if it would be permissible.* In other words, if it comes out as a chemical precipitate of pure copper I don't see how the Treasury could allow that, if the ruling is the same that it is on quicksilver. It is a ruling for the Treasury, though, I think the Treasury does not like to be forced to make that ruling. They have to draw a line somewhere, I suppose, so they have to do it. I know the miners would be much more pleased if the Senate would make the decision and make it hard and fast and we could make it hard and fast and take the load off the Treasury Department. I hope they would appreciate it. I would like to save them work if we could, but that ruling as it is, especially on the new strategic metals not consid-

ered in the past, which were not produced in the past and which are being handled by entirely new and different processes are going to suffer tremendously on that account. Any chemical change in the ore value cannot be permitted in that base depletion but it has to be taken out as a cost, the profit applied to that particular process, and also has to be taken out. It is not as if you could take off the cost of that, but if the cost is half and half and they disallow processing then half of the profit is applicable to that and cannot be used as a depletion base. It is a point which I did not bring up at Reno because I had heard about it later. I thought it was important to get it into the record here. [Italics supplied.]

Senator MURDOCK. Did you hear Mr. Searls, the attorney from San Francisco? I think he suggested an amendment, did he not?

Mr. CAMPBELL. To take care of the situation we are now discussing?

The CHAIRMAN. Thank you very much, Mr. Williston.

Mr. CALLAHAN. In connection with that interpretation and this ruling by the Treasury, with regard to change of the character of ore due to a chemical process, I happened to be present before the Finance Committee when the original percentage depletion amendment was put in the law, and following that I was present at conference held with the Treasury officials who were going to write the regulations. I can say definitely from my own memory as far as those conversations at that time, in writing the regulations for the amendment which had just been passed by the Congress, I know very definitely there was no intent other than the 15 percent depletion allowance would apply in a case such as Mr. Williston refers to.

Mr. WILLISTON. I am glad to hear that, Mr. Calla-

han. One of our quicksilver companies has a tax appeal up now. The Treasury feels the other way about it, and it has gone to the appeal court, but the Idaho Alma Dean has to deduct it. That is Idaho's former largest producer. The Bradley Mining Co. and Gould in California both have to suffer under it, they have a deduction on that account, and [862] the Bonanza Mining Co. have all, I believe, a tax-appeal case up. I think they are the first ones to fight it, but I know it has been brought to the mercury industry within the last 3 years.

Mr. ANDRESEN. May I make a statement?

The CHAIRMAN. Yes, Mr. Andresen.

Mr. ANDRESEN. In connection with this matter, the phrase "ruling" has been used rather frequently. To clear the record, I would like to point out that the provision referred to is not a ruling of the Treasury, it is the provision of the regulations which were promulgated by the Commissioner in 1932 to give effect to the Revenue Act of 1932 and which was amended in the regulations promulgated in 1940. Regulations 103 provide:

> (f) "Gross income from the property," as used in section 114(b) (3) and (4) and sections 19.23(m)-1 to 19.23(m)-28, inclusive, means *the amount for which the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine or well*, but, if the product is transported or processed (other than by the processes excepted below) before sale, it means the representative market or field price (as of the date of sale) of crude mineral product of like kind and grade before such transportation or processing. *If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting*

from any process or processes (or, if the product in its crude state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation and the processes not listed below). The processes excepted are as follows:

(1) In the case of coal—cleaning, breaking, sizing, and loading at the mine for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading at the mine for shipment;

(3) In the case of iron ore and ores which are customarily sold in the form of the crude mineral product—sorting or concentrating to bring to shipping grade, and loading at the mine for shipment; and

(4) *In the case of lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product—crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined product on the other) than crushing and concentrating (by gravity or flotation).*

In case any of the accepted processes are not applied in the immediate vicinity of the mining district in which the mine is located, costs incurred for transportation to the processing location and, if transported by taxpayer, the proportionate profits attributable to transportation should be subtracted from the sale price of the product to determine "gross income from the property." [Italics ours.]

This general question involved here has been the subject of litigation in connection with the oil and gas cases for a number of years. The Supreme Court of the United States in the case of Wilshire Oil Co., 308 U.S. 90, declared that this phrase "gross income from the property" and "net income from the prop-

erty" as used in these regulations from which I have quoted is an ambiguous phrase peculiarly appropriate for administrative construction and interpretation and denied the contention of the Wilshire Oil Co. in that instance as against the ordinary interpretation of these words. The Court held for the Government on the ground that the provision was an ambiguous phrase and the Commissioner's interpretation of it was reasonable and fair.

We have had, admittedly, a difficult problem in the administration of this law. It has been in my experience in the past 18 years in the Bureau of Internal Revenue that this is one of the most difficult problems. I have been repeatedly accused by taxpayers of being hard- [863] boiled and unsympathetic with their problems. On the other hand, the Treasury is today face to face with a number of very important cases involving large sums of money. In one of them the Commissioner is the defendant in a suit for a refund for very large sums which involve the basic question we are considering here. So you can see, perhaps, from my remarks, this is not an easy question, and I hope I have convinced you that I have no desire to be anything but sympathetic for the mining industry in this matter, no desire to do anything but administer this law in a way that produces a fair and equitable result.

Mr. CALLAHAN. May I say when I stated I had conversations with the Treasury following the passage of this law, I realize Mr. Andresen is correct regarding the regulations of the Bureau of Internal Revenue. One remark I would like to make is that where there is such an ambiguity, it seems strange that inevitably the Bureau of Internal Revenue and the Treasury find it much more convenient to determine and resolve that ambiguity against the taxpayer.

Now, sometimes we would like to have just a little bit more sympathy, and we would like to have it understood that the taxpayer is the one, after all, for whom these tax bills are written. *In this particular case there is no question about the understanding about that percentage depletion amendment or why it was written into the law. It was to apply that way. An ambiguity crept in there as a matter of language. It is just too bad, of course, and it is also too bad that the questions ever have to come up.* [Italics supplied.]

Senator MURDOCK. May I ask you this question, Mr. Callahan: At the meeting at Reno we seemed to have a difference of opinion there between two people speaking for the mining industry, one a mining engineer, as I recall it, and the other an attorney for large mining interests. *The mining engineer, as I understood him, wanted to include the smelting charges, add them in connection with your gross, whereas the attorney of the mining interests seemed to think that was going a step too far.* Have you got anything to say on just where the process on crude oil and, say, the copper, the lead, or the zinc in the metals state; should this rule be applied in regulations? [Italics supplied.]

Mr. CALLAHAN. *Of course, a mining engineer, being an operator and interested in the product would want to apply the smelting charges as well,* but I am a lawyer, so I have to take another viewpoint. *I don't think that was ever intended in the law.* I don't think it was discussed. I will have to take the lawyer's viewpoint on that. [Italics supplied.]

Mr. FERNALD. Mr. Andresen is referring to the first regulations. I would like very much if he would read in the phrase as to what it was that was to be excluded as to processes beyond those referred to, the phrase

which, in those regulations, was, after considerable consideration by the Treasury, written as the cost of those processes, and *it was only some years afterward that "profits attributable thereto" was written.* In the first one it was confined to cost of the substitute process, not attributing any profits to them. I think Mr. Andresen has that phrase before him. [Italics supplied.]

Mr. ANDRESEN. Mr. Fernald has described the situation. The regulations of 1932 provided that:

> * * * in the event it was necessary to work back from the price of the refined product to get the gross income at the mine, it was to be done by deducting the [864] cost of the processes which came after crushing and concentration, by gravity, or flotation.

The provision of the regulation is written that way. The Commissioner found that a substantial number of taxpayers were making the computation in that literal way, and that it had the effect of putting all of the profits from marketing, refining, smelting, and railroading back into the mine. In other words, we almost concluded that some of the great copper mines of the world were actually gold mines because all of the profits that were derived after the ore passed out of the mine were ploughed back into the mine in their computations of the depletion allowance. Therefore the Commissioner amended the regulations. Treasury Decision 4960 promulgated in January 1940 introduced into this paragraph a phrase:

> * * * requiring the deduction of the costs of these additional processes and the proportionate profits relating thereto.

The amended regulation had the effect of giving all taxpayers the same basis for a depletion allowance, namely, the actual gross income from the mine alone.

The treatment contended for by Mr. Fernald and others would greatly favor the major operators who own and operate smelters and other facilities in addition to mines. [Italics supplied.]

This Treasury decision has now been in force for some 2½ years. Since then the Congress has enacted the Revenue Act of 1940, the Second Revenue Act of 1940, the Revenue Act of 1941. Under the rule that the successive reenactment of the statute after the regulation has been changed the Commissioner would contend that the regulation now has the force and effect of the law.

Mr. FERNALD. Might I observe the contemporaneous interpretation of the law at the time it was first passed in 1932 was that the word "profit" should not be included? Mr. Andresen's statement is that that continued while we had the Revenue Acts of 1933, 1934, 1935, 1936, 1937, 1938, and 1939 so consequently that must have been the law in 1940, isn't that clear?

I would also like to bring out that for those many years it was customary to deal with the matter of the cyaniding, if I am rightly informed, under the Treasury regulations, so as not to exclude the entire cost of the cyaniding process, but only so much of that as was considered as going beyond what a concentrating cost would have been, and it is only very recently that the new rulings or interpretation which had existed for 8 years, since the early interpretation of that section. I think I would be very much interested if Mr. Andresen will state for the record just what was the early interpretation of the cyaniding proposition.

The CHAIRMAN. Would you care to state that, Mr. Andresen?

Mr. ANDRESEN. I think Mr. Fernald has given us a correct picture of the early interpretation of the original regulation. After some years the Commis-

sioner came to the conclusion it was producing a result that was not in keeping with the intent of the Congress in this matter, hence the regulation was changed in 1940.

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Statement of HENRY B. FERNALD, Chairman, Tax Committee, American Mining Congress:

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TAXATION

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[1002]

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In addition to the foregoing, there has been criticism expressed of certain rulings and interpretations by the Bureau of Internal Revenue or its employees; particularly as to its interpretations and practice regarding "gross income from the property" in computing percentage depletion. As bearing on this matter, I am filing a memorandum, exhibit A, which brings out (1) the meaning this term was intended to have as used in the first report of the staff of the joint congressional committee regarding percentage depletion of mines, and (2) certain recent changes in Treasury interpretation or Bureau practice. This memorandum may be helpful in the further consideration of this subject.

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[1008]

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As to the Meaning of "Gross Income From the Property" in Computation of Percentage Depletion

Criticism has been voiced of the present Bureau practice in determination of the allowance for depletion to represent 15 percent of the "gross income from the property." This is not the time nor place to argue whether or not the Bureau practice gives the proper interpretation to the wording of existing law. *The basic thought here expressed is that such interpretation does not give to many mines the allowance which they should have and which they thought was granted them when the law was enacted. It does not even give to many the allowance which the Treasury Department, by its regulations and administrative practice, granted to them for many years after first enactment of this provision.* [Italics supplied.]

(1) *As to the original intention of this provision, reference is made to a report of Alex R. Shepherd to L. H. Parker, Chief, Division of Investigation, Joint Committee on Internal Revenue Taxation,* which appears as Appendix XXXI, page 65, to a report of Mr. Parker to Chairman Hawley, September 17, 1929, and of Chairman Hawley to the joint committee, September 19, 1929. (Reports to the Joint Committee on Internal Revenue Taxation From Its Staff, Vol. 11, p. 8, 1929.) [Italics supplied.]

[1009] In that report (p. 67) it is stated—

> The average depletion allowed for all metals is approximately 17 percent of the gross sales for this period.

Also on page 67 is—

> Table 1.—Summary of the metal industries for a 5-year period (1922–26), showing the gross sales (equivalent to the gross income from the property) * * *

On page 68 it is stated—

> Table 1 shows that the metal-mining industry has received in depletion allowances an average deduction equivalent to about 17 percent of the gross sales.
>
> From the study of this subject it is believed that 15 percent of the gross sales value with a 50 percent limitation to net income, would be a reasonable rate to allow the metal-mining industry for the future. This reduction by 2 percent of the actual figures shown in the summary is thought advisable to offset the continuing effect of the percentage-depletion method.

Elsewhere reference is made to—

> 15 percent depletion allowances on gross sales;
> 15 percent of their gross sales;
> 15 percent to gross sales.

Thereafter, on page 70, the report recommends that the wording of the act should follow that for oil and gas, reading "15 percent of gross income from the property," and that the necessary definitions should be written into the regulations.

On pages 72–73 there is a discussion of various metals and the basis to be used, with the recommendation that—

> For the purpose of this subdivision "the gross income from the property" shall be the competitive market receipts, or its equivalent, received from the sale of the crude, partially beneficiated or refined gold, silver, or copper, the product actually disposed of by the taxpayers to govern the method of computation of receipts in all cases, and in the case of all other metals, coal and oil and gas, the competitive market receipts, or its equivalent, received from the sale of the crude products, or concentrates on an f.o.b. mine, mill, or well basis.

Illustrative examples are given (pp. 74–75) showing the results of the 15 percent computation:

> For lead, 15 percent of a 7.53-cent sale price per pound of lead;
>
> For zinc concentrates, 15 percent of a $50 per ton gross sales price at mill for the concentrates;
>
> For iron ore, 15 percent of a $2.68 per ton sales price f.o.b. cars at mine for the ore;
>
> For copper, 15 percent of a 14-cent sales price per pound of copper.

There can be no question that this report contemplated that the 15 percent "gross income from the property" was to be applied to the finished metals recovered where that was the established form in which the product was marketed. This was clearly the contemplation as to copper, lead, gold, and silver. (No thought seems to have been given at that time to such products as quicksilver, which were not then important subjects of domestic production, but the furnacing or retorting of quicksilver ores is generally regarded as the equivalent of concentration.)

Without argument as to the legal weight which should be attached to this report, we may at least say it gave substantial support to the belief that this was the interpretation which should be placed upon the expression "gross income from the property."

(2) *As to the Treasury interpretation, the original regulations prescribed* that for "lead, zinc, copper, gold, or silver ores and ores [1010] which are not customarily sold in the form of the crude mineral product" *a cut-off should be made at "concentrating (by gravity or flotation) and other processes to the extent to which they do not beneficiate the product to a greater degree * * *," and "the costs" of any further processes or transportation were to be deducted from the sales price to arrive at a "gross income from the*

property." Under this regulation, if a company sold its own metals, the costs of smelting, refining, and transportation (beyond the concentrating stage) would be deducted from selling price realized, and the remainder would be "gross income from the property." [Italics supplied.]

Moreover, under this regulation, the Bureau in practice considered cyaniding as substantially equivalent to concentrating, and its cost was not deducted in computing "gross income from the property." [Italics supplied.]

These regulations and this practice continued for many years (while the law was repeatedly reenacted), *but in 1940 the regulations were amended to require that not merely "the costs" but also the "proportionate profits attributable to" the processes or transportation beyond concentration should be deducted in computing "gross income from the property."* [Italics supplied.]

Later, also, the Bureau, with no change in law or regulations with regard thereto, has changed its practice as to treatment of cyaniding and now proposes to hold that cyaniding shall no longer be considered as substantially equivalent to concentrating; but that cost of cyaniding (plus profits attributable thereto) shall be deducted in computing "gross income from the property." [Italics supplied.]

The principal criticisms which have been presented to your committee seem to fall under the following heads: [Italics supplied.]

(a) That practice and rulings with respect to cyaniding, established when the law was first enacted and continued for many years, have now been reversed.

(b) That the regulations, as originally promulgated and continued for many years, have been changed to require or permit profits to be

attributed to certain processes and deducted in computing "gross income from the property," whereas the most that should be done, even under the original regulations, would be to deduct the costs of such processes.

(c) That the interpretation given to the law by the regulations (whether or not legally correct) fails to carry out the original intent of the percentage depletion provision, and does not give the appropriate allowance for quicksilver and other metals.

In presenting this subject to your committee, it is not our purpose to ask you to pass upon the correctness of legal or technical interpretations of the present wording of the law; but we call to your attention the apparent need for writing into the law such definition of "gross income from the property" as will insure that the intended reasonable allowance for percentage depletion will be made in such cases.

The CHAIRMAN. Thank you, Mr. Fernald.

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[1018]

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(Senator McNary submitted for the record a copy of a resolution adopted by the Oregon Mining Association on August 3, 1942, entitled "Prospecting and Development of Strategic Metals.")

* * * * *

"*Resolved.* That our Oregon Senators and Representatives be urged to make every effort to amend the 1942 revenue bill to make it possible for private capital to explore, develop, and produce the short-lived deposits of strategic and critical minerals and metals by:

"1. Removing the excess-profits tax from strategic metals production or guaranteeing the return of capital invested in strategic metal production.

"2. Maintain present depletion allowances and make the bill more definite so that the Treasury Department may not by arbitrary regulation reduce depletion allowances as it already has with quicksilver, and may with other strategic metals.
[1037]

77th Congress 2d Session — SENATE — Report No. 1582

RECOMMENDATIONS OF SENATE SPECIAL SILVER COMMITTEE WITH RESPECT TO TAXATION OF MINES ENGAGED IN THE PRODUCTION OF NONFERROUS METALS FOR USE IN THE WAR EFFORT

August 20, 1942.—Ordered To Be Printed

Mr. THOMAS of Oklahoma, from the Special Silver Committee, submitted the following:

PARTIAL REPORT

[Pursuant to S. Res. 187, 74th Cong., as amended by S. Res. 261]

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[1038]

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This committee makes the following recommendations with regard to taxes, based on the information which was furnished at the hearings:

(1) There must be adequate allowance for depletion. The provisions of the pending bill (H.R. 7378) should be retained. There should be no curtailment of these allowances such as proposed by the Secretary of the Treasury.

Further, the inequities created under previous tax laws and their administration, whereby mining tax-

payers have been denied the right to use the percentage depletion method through technicalities or lack of adequate notification, should be corrected for the years 1932 to 1941, inclusive.

* * * * *

[1039]

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(11) Rulings and interpretations of the Treasury should not be so drawn as to curtail the rights of taxpayers under the revenue laws as enacted by the Congress. We criticize particularly the interpretations by the Bureau of Internal Revenue of the "gross income from the property" upon which percentage depletion allowances are computed.

Senate Hearings, 1942

(Revenue Act of 1942, Hearings before the Committee on Finance, United States Senate, 77th Cong, 2d Sess., on H.R. 7378)

[Vol. 1]

[969] Statement of HENRY B. FERNALD, Montclair, N.J., chairman, Tax Committee, American Mining Congress:

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[970] *In the recent hearings of the Senate Silver Committee*, presided over by Senator McCarran, in Nevada, Utah, and Colorado, the representatives of the mining industry of those States and the neighboring States, such as Montana, Idaho, Oregon, California, Arizona, and [971] New Mexico, discussed the effect of taxation upon their operations. I attended these hearings and listened to the presentations made. I cannot forecast the report the committee will make with regard to them, but I state by own conclusions, concurred in by the tax committee

of the American Mining Congress. [Italics supplied.]

There was general agreement among mining men that taxation was obstructing production—particularly where additional financing was needed. To indicate why this is so, I set forth certain typical situations:

* * * * *

[973] I. Depletion.

It is essential that proper depletion allowances be made. I shall not speak at length on this because it will be a subject of special presentation to your committee by others, but we urge that the provisions of the House bill as they are before you be continued. These fairly and rightly meet the general needs of the mining industry. There are certain special situations of which I shall later speak.

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[Vol. 2]

[1311] Statement of Hon. THOMAS P. GORE, Oklahoma City, Okla., representing Mid-Continent Oil & Gas Association and Independent Petroleum Association of America:

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[1322] Mr. Chairman, I would like to reserve the right to submit a supplemental statement in further answer to Senator Barkley's question, giving an historic background to the schedule of percentage allowances. These percentages were not fixed ad capitandum. They were the result of several investigations, both official and unofficial. One of the investigations indicated that the discovery depletion allowance on behalf of metals in a period of 5 years amounted to a little more than 17 percent *of the smelter return, which was the gross selling price of the ore.* But when Congress substituted percentage depletion, in the case of mines, it fixed the percentage

at 15, which time has proved was too little. Fortunately the percentage allowance on behalf of oil and gas was neither too little nor too late. [Italics supplied.]

(The supplemental statement referred to is as follows:)

Supplemental statement of Hon. THOMAS P. GORE, Oklahoma City, Okla.

* * * * *

[1323] The percentage depletion provisions as applied to the mining industry were not adopted by Congress until 1932. Until that time, this industry had continued to receive allowances for depletion based upon discovery value, however, the administration of same had progressively become more and more difficult and costly. It was due to these great administrative difficulties that the committees of Congress in 1932 eliminated the discovery depletion allowance in favor of a percentage of income provision.

The percentage rate was determined by studying the average of the depletion allowed under the discovery value method, taking the weighted average over a 5-year period; and it was found that in the case of metal mines this amounted to slightly in excess of 17 percent of the smelter return, which was the gross selling price of the ore.

The rate of 15 percent, which was acceptable to the metal-mining industry, was agreed upon by the Congress more or less as a compromise, and was considered conservative in view of the fact that it was considerably less than the average rate that was allowed over the prior years.

Now I wish to point out that in the case of both the oil and gas industry and the mining industry the rates or percentages of income, by which the depletion

allowances were measured, were arrived at by means of extensive studies conducted by the Bureau of Internal Revenue and the staff of the Joint Committee on Internal Revenue Taxation. Also, these rates were fully supported by studies made by the industries themselves. Furthermore, and in each instance, the rates finally fixed by Congress were considerably less than the percentage which the depletion allowance under the prior system bore to the taxpayers gross income.

* * * * *

S. Rep. No. 1631

(77th Cong., 2d Sess. (1942) (1942–2 Cum. Bull.) 504 [to accompany H.R. 7378])

[65] DETAILED DISCUSSION OF THE TECHNICAL PROVISIONS OF THE BILL.

* * * * *

[115] SECTION 147. PERCENTAGE DEPLETION FOR COAL, FLUORSPAR, AND METAL MINES AND SULPHUR

This section is identical with section 131 of the House bill.

This amendment provides that fluorspar mines are to be allowed percentage depletion at a rate of 15 percent, *subject to the same limitations as are applicable in the case of metal mines.* For taxable years beginning after December 31, 1941, the depletion deduction for coal, fluorspar, metal, and sulphur mines may be computed (without regard to any election) either on the percentage basis or on the cost basis, whichever gives the greater deduction. [Italics supplied.]

(88 Cong. Record (Part 6))

[8033] Mr. THOMAS of Idaho. When the amendments providing for percentage depletion were under consideration *in 1932*, it was our understanding that the *ordinary treatment processes which a mine operator would normally apply in order to obtain a suitable product should be considered as a part of the mining operation*. Is any change in that law proposed at this time? [Italics supplied.]

Mr. JOHNSON of Colorado. Mr. President, I am glad the Senator brought up that subject, because it is one in which the Senator from Colorado has been very much interested, and it has been discussed in the Senate Finance Committee at considerable length. I am especially interested in the beneficiation of quicksilver, although no quicksilver is produced in the State of Colorado. But we have been met with this sort of situation with respect to quicksilver. If the producers of quicksilver will follow a certain process of beneficiation, they will receive the benefits of depletion fully, but if they adopt a more scientific method and a more modern method, then, of course, they run immediately into certain difficulties. That, to me, is something which is directly opposed to the public interest, and especially when we need quicksilver as badly as we do.

The question of what constitutes net income attributable to the mining of strategic metals and the companion questions regarding gross and net income from the property for percentage depletion have been considered with Mr. Randolph Paul, who has represented the Treasury before the Finance Committee on this subject. Mr. Paul urged that this was a subject which should be covered by Treasury regulations rather than

by detailed provisions of the law. *I agree that the statutes should not be burdened with regulatory details to fit every possible contingency.* I hope the Senator from Idaho will not offer an amendment on the subject at this time. [Italics supplied.]

The Congress has not intended in the pending measure to make any change in its concept of mining income from that expressed in the 1932 and 1934 acts, nor to establish by implication or otherwise any approval of Treasury regulation or Revenue Bureau practice which departs from the *original* acts or the general Bureau practice prior to 1940. [Italics supplied.]

I have conferred with Mr. Paul and he has stated to me the Treasury's intention to adhere to the original regulations and procedures under these acts, so that concentration by gravity or flotation and equivalent processes would be considered as part of the mining operation. Thus, for example, the furnacing of quicksilver ores would be considered as an equivalent of concentration by gravity or flotation.

Mr. Paul made only one *exception* to the *original* regulations; namely, that there would be excluded from gross income from the property *not only the cost of further processes such as smelting, but also the profits if any, attributable thereto;* intending thus to make the charges for a mining company's own smelter compare with those of an independent custom smelter. [Italics supplied.]

Mr. President, does that explain the situation to the Senator from Idaho, and is he satisfied with the explanation?

Mr. THOMAS of Idaho. Mr. President, I think with that explanation the situation is entirely satisfactory. What I was particularly anxious to know was whether the provision in question would make any changes in

the matter of depletion in the operations to which I referred. I was very active in 1932 in connection with the passage of the legislation on the subject. The same system is still being followed, I understand.

Mr. JOHNSON of Colorado. *Yes; the same system is being followed.* I know the Senator from Idaho took a very active part in having the legislation adopted in 1932. The Senator himself sponsored an amendment with respect to depletion in connection with the mining operations to which he referred. [Italics supplied.]

* * * * *

Revenue Act of 1942

(c. 619, 56 Stat. 798)

SEC. 145. PERCENTAGE DEPLETION FOR COAL, FLUORSPAR, BALL AND SAGGER CLAY, ROCK ASPHALT, AND METAL MINES AND SULPHUR.

(a) *Percentage Depletion.*—Section 114(b)(4) is amended to read as follows:

"(4) *Percentage Depletion for Coal, Fluorspar, Ball and Sagger Clay, Rock Asphalt, and Metal Mines and Sulphur.*—The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, fluorspar, ball and sagger clay or rock asphalt mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph."

(b) *Discovery Depletion Not Applicable to Fluorspar, Ball and Sagger Clay or Rock Asphalt Mines.*—Section 114(b)(2) is amended by striking out "metal, coal, or sulphur mines" and inserting in lieu thereof "metal, coal, fluorspar, ball and sagger clay, rock asphalt, or sulphur mines".

1943

[Section 124 of the Revenue Act of 1943, c. 63, 58 Stat. 21, 44, added to the definition of "gross income from the property" to Code Section 114(b)(4) and in addition granted percentage depletion to certain critical minerals for the duration of the war. The definition of "gross income from the property" originated in the Senate and was revised in conference. The pertinent legislative reports, hearings, congressional debate, as well as the amending statute and the amended Treasury Regulations promulgated thereunder, are set forth below in chronological order.]

H. Rep. No. 871

(78th Cong., 1st Sess. (1944 Cum. Bull. 901))

[48] SEC. 114. Percentage Depletion for Flake Graphite, Vermiculite, Potash, Beryl, Feldspar, Mica, Lepidolite, and Spodumene.

Subsection (a) of this section amends the heading and the first sentence of section 114(b)(4), relating to percentage depletion for coal, fluorspar, ball and sagger clay, rock asphalt, and metal mines, and sulphur, so as to include among the mines or deposits entitled to percentage depletion flake graphite, vermiculite, beryl, feldspar, mica, lepidolite, spodumene, and potash. In the case of flake graphite, vermiculite, beryl, feldspar, mica, lepidolite, and spodumene mines, the

allowance for depletion shall be 15 percent, and in the case of potash mines or deposits, the allowance for depletion shall be 23 percent, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. This allowance is subject to the further limitations contained in the existing provisions of section 114(b)(4).

Subsection (b) amends section 114(b)(2) relating to discovery value of certain mines, so as to debar the use of the discovery value as the basis for depletion in the case of flake graphite, vermiculite, beryl, feldspar, mica, lepidolite, spodumene, and potash mines.

Subsection (c) provides that the amendments made by subsections (a) and (b), insofar as they apply to flake graphite mines, shall be applicable to taxable years beginning after December 31, 1942.

Subsection (d) provides that the amendments made by subsections (a) and (b) and the amendments made to section 114 of the code by section 145 of the Revenue Act of 1942, providing percentage depletion for fluorspar, ball and sagger clay, and rock asphalt, shall not be applicable to any taxable year beginning on or after the date of the termination of hostilities.

Senate Hearings, 1943

(Revenue Act of 1943, Hearings before the Committee on Finance, United States Senate, 78th Cong., 1st Sess., on H.R. 3687)

[25] Statement of RANDOLPH PAUL, General Counsel of the Treasury:

[66]

* * * * *

The Treasury's position with respect to the extension of percentage depletion to strategic minerals as a wartime measure is the same as that with respect to the exemption of these minerals from excess-profits taxes. If, but only if, the allowance of percentage depletion for the duration of hostilities will contribute to the war effort, the Treasury recognizes the advantages of such allowances despite our firm conviction that the percentage depletion provisions in the present law have, in general, enabled many individual and [68] corporate taxpayers to avoid their fair share of the Nation's tax burden. Generally, our position with respect to percentage depletion is the same as was expressed in hearings on the 1942 revenue bill.[1]

However, on the basis of the representations of the War Production Board that percentage depletion for these metals for the duration of the war will contribute to the war effort, we concur in the action taken in the House bill in granting percentage depletion to fluorspar, flake graphite, sheet mica, and beryl.

On the other hand, the Treasury does not believe that the extension of percentage depletion to vermiculite, feldspar, lepidolite, spodumene, and potash can be justified even as a war measure. * * *

* * * * *

[527] Statement of DONALD H. MCLAUGHLIN, representing the Tax Committee of the American Mining Congress:

Mr. MCLAUGHLIN. Mr. Chairman, on behalf of the tax committee of the American Mining Congress, of which I am a member, I am speaking in support of the amendment introduced by Senator Johnson to the section of the revenue bill that pertains to gross in-

[1] See Secretary Morgenthau's statement, p. 8, and testimony of Randolph Paul, pp. 84, 2988, 3438, hearings before Ways and Means Committee, 77th Cong., 2d sess.

come from the property for purposes of percentage depletion.

When percentage depletion was introduced in the Revenue Act of 1932, the Treasury Regulations under which it was to be administered were the subject of conferences between Assistant Secretary Douglas and others of the Treasury Department, and representatives of the mining industry among whom I was included. The regulations then adopted have been preserved essentially in their present form as far as definition of "gross income" is concerned except for a single amendment in 1940 with regard to allocation of a portion of the profits of a mining enterprise to certain processes or operations to which reference will be made later.

When the 1932 regulations were adopted, it was understood by the representatives of the mining industry that the omission of a complete recital of the many processes by which ores are beneficiated was simply to avoid burdening the regulations with a lengthy and possibly incomplete statement, and that the meaning of the act was met by the inclusion of phrases such as "other processes" which were deemed adequate to cover other common methods of treatment similar in their function to those specified. With the regulations in this form, it was believed that the administration of the law would not depart from what we had been informed was the intent of the Members of Congress who had sponsored the legislation. [Italics supplied.]

This was clearly expressed later upon the floor of the Senate by Senator Thomas when in a discussion with Senator Johnson (p. 8291, vol. 88, Congressional Record, 77th Cong., 2d sess.), he said:

> When the amendments providing for percentage depletion were under consideration in

1932, it was our understanding that the ordinary treatment processes, which a mine operator would normally apply in order to obtain a suitable product, should be considered as a part of the mining operation.

That this understanding was well founded and expressed the agreement reached at this conference with Assistant Secretary Douglas is clearly borne out by the action of the Bureau of Internal Revenue for the next 8 years in accepting and settling tax returns based upon it. During this period, the law with regard to percentage depletion was repeatedly reenacted and the regulations remained essentially unchanged. *For example, in the case of gold mines, common processes such as amalgamation and cyanidation were regarded as the equivalent of concentration by gravity or flotation, and no distinction was made between the tax return of a company employing the former as its major method of beneficiation and one that happened to find the latter better suited to its ores.* [Italics supplied.]

In 1941, however, the Bureau unexpectedly took a position that implied it had been in error in the preceding years and claimed deficiencies in the returns of a number of companies for the years 1938, 1939, and 1940, which were the only ones still open for adjustment, by requiring that the cost of processes *such as cyanidation in the case of gold ores and furnacing in the case of quicksilver ores* [528] must be deducted in calculating gross income, upon which percentage depletion was based, on the grounds that these processes were not specifically mentioned in the regulations. This current stand of the Bureau is not based on any public statements, so it is difficult to know just how far it is intended to go in excluding one after another of the well recognized processes of beneficiation from the group that was formerly accepted as the

equivalent of concentration by gravity or flotation, but from the various cases that have now arisen, the taxpayer cannot avoid feeling apprehensive that the term "other processes" in the regulations is no longer of any significance in the eyes of the Treasury. [Italics supplied.]

The question of allotment of profits to specific processes of beneficiation was discussed at the conferences in 1932, but it was ruled out on account of the difficulties of administering it in a simple and equitable way not subject to controversy. In spite of these considerations that were regarded as compelling in 1932, provision for allotment of a portion of the profits to processes subsequent to those mentioned was made in the regulations issued in 1940 and applied in the claims for deficiencies to which reference is made above. [Italics supplied.]

As a result, the differences in treatment of taxpayers, even in the same type of mining operations, have been so great and inequitable that the wisdom of the early decision to keep the administration of the law on as simple a basis as possible has been confirmed in a most positive way.

The proposed amendment simply incorporates in the law the practices established by the Bureau under the 1932 regulations, and does not modify the existing regulations in any essential way except to limit the deductions in calculating gross income to the costs of the processes or services subsequent to those which are regarded as ordinary treatment processes and specifically stated as such. [Italics supplied.]

The clarification of the law that would be accomplished by this amendment would relieve many taxpayers not only of uncertainties with regard to their tax liabilities but also with regard to choice of technical practices, for the present policies of the Bureau

create such discriminations between processes designed to accomplish identical ends that a taxpayer might feel compelled to replace an entirely satisfactory plant with one of a type that now happens to be specifically mentioned in the regulations. [Italics supplied.]

Consequently, I feel strongly that *in the interest of fair treatment as between taxpayers in the mining industry* and *simplicity in the administration of the revenue act* it is imperative to remove these sources of uncertainty and conflict by adopting the proposed amendment that *restores Treasury procedure to that which was originally intended by Congress and that makes unmistakably clear just what can and what cannot be deducted from the value of the output of mines in calculating their depletion base.* [Italics supplied.]

(The amendment by SENATOR JOHNSON, referred to above, is as follows:)

[529] Amendment intended to be proposed by Mr. JOHNSON of Colorado to the bill (H.R. 3687) to provide revenue, and for other purposes, viz: at the proper place, insert the following:

SEC.—*Gross Income From Property for Purposes of Percentage Depletion.*

(a) Section 114(b)(4) is amended by adding at the end thereof a new subparagraph, (B), to read as follows:

> "(B) Definition of Gross Income From Property.—As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine

owners or operators in order to obtain the commercially marketable mineral product or products. The term 'ordinary treatment processes' as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulfur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, precipitation (but not including electrolytic deposition), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. In the determination of such gross income from mining, there shall be excluded the costs of any process or service which does not constitute an ordinary treatment process. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 731 and 735."

(b) the amendment made by subsection (a) hereof shall be effective as of the date of enactment of the Internal Revenue Code.

(c) Section 114(b)(4) of the Revenue Act of 1938 and the corresponding provisions of the Revenue Acts of 1936, 1934, and 1932, as amended, are hereby amended by inserting therein the amendment con-

tained in subsection (a), other than the last sentence thereof, such amendment to be effective as of the date of enactment of each of the respective Acts.

* * * * *

[785] Statement of GORDON G. CROWDER, Chairman, Special Tax Committee, National Coal Association:

* * * * *

[786]

* * * * *

Seventh, Senator Johnson of Colorado has proposed an amendment to the pending bill to provide a proper definition of gross income from property for purposes of percentage depletion. Senator Thomas of Oklahoma has proposed an amendment to the pending bill dealing with termination of percentage depletion for certain minerals. The National Coal Association supports these amendments and urges that the committee adopt them.

* * * * *

[839]

* * * * *

SENATOR WALSH. A memorandum for inclusion in the record has been submitted by Mr. A. T. Kearney of the committee of vermiculite miners which will be inserted in the record at this point.

(The memorandum referred to is as follows:)

* * * * *

[842] Summary of Memorandum Regarding Percentage Depletion for Vermiculite:

1. Vermiculite is a nonmetallic mineral found in North and South Carolina, Colorado, Texas, Montana, and Wyoming.

2. The War Production Board has reported to the Ways and Means Committee that its continued production is essential to the war effort.

3. Vermiculite, a fireproof insulating material, is used principally in the war effort for combat war planes, airplane engine test sheds, oilless bearings for tanks, ship decking, fireproof bulkheads for ships, sound-deadening and insulating materials for walls, floors, and roof decks for hospitals, Army and Navy camps, and other types of war buildings.

4. Estimated 1943 production will be about 46,000 tons. Estimated demand for 1943 will be in excess of 65,000 tons.

* * * * *

[842] 9. Processors and fabricators who purchase ore from vermiculite miners have invested more than $2,000,000 in their businesses. Estimated sales in 1942 by processors, fabricators, and dealers exceeded $6,000,000, on which total estimated income taxes in excess of $200,000 were paid.

10. If percentage depletion were permitted *miners*, a steady flow of a *basic material* to *fabricators and processors* would be assured. This would serve the war effort, continue tax revenue presently being collected from that source, and, in addition, would provide increase in tax revenue from processors, fabricators, and dealers which would more than offset any loss of revenue from vermiculite miners. [Italics supplied.]

11. The Ways and Means Committee have voted to include vermiculite in the new revenue act with those minerals on which 15 percent depletion is allowed.

* * * * *

[926] Statement of HENRY B. FERNALD, Chairman, Tax Committee, American Mining Congress:

Mr. FERNALD. Mr. Chairman, on behalf of the mining industry we submit the following statement re-

garding certain features to which we urge your attention in connection with the pending tax bill. [927]

* * * * *

We believe Congress has intended to recognize fully the need for capital allowances for mines so that there should be taxed as income or as excess profits only that which remains after full capital allowances. In the framing of our laws and their application by the Treasury that intent is not being fully observed. This is not a quibble over particular words or phrases and their interpretation, but it is a matter of substance and practical application. So we call to your attention certain points where amendment of the law seems necessary to express what we believe was the congressional intent that the exceedingly [928] high rates imposed on taxable income should not be applied to capital realization:

1. Gross income from the property: The allowances for percentage depletion and the excess-profits tax exemptions of strategic minerals, of above-quota bonus and and of excess output, all depend to a considerable extent on the definition of "gross income from the property." *There is immediate need for writing into the law a definition which will express the congressional intent. This has been the subject of special presentation to you by Dr. Donald H. McLaughlin in which he has explained to you why we so strongly urge the adoption of the amendment which Senator Johnson has proposed.* [Italics supplied.]

* * * * *

S. Rep. No. 627

(78th Cong., 1st Sess. (1944 Cum. Bull. 973))

[23]

* * * * *

PERCENTAGE DEPLETION

Under the House bill, percentage depletion is extended to flake graphite, vermiculite, potash, beryl, feldspar, mica, lepidolite, and spodumene, in addition to those minerals presently receiving it, and discovery depletion is consequently terminated with respect to these minerals. The extension to flake graphite applies to years beginning after December 31, 1942, but the extensions made by this bill and the Revenue Act of 1942 are limited to the duration of the war.

Your committee makes three changes in this provision. It includes a mineral by the name of talc, and in the case of potash, it reduces the rate from 23 percent to 15 percent and makes the allowance permanent and not limited to the duration of the war.

DECLARATION OF GROSS INCOME FROM THE PROPERTY IN THE CASE OF PERCENTAGE DEPLETION

Section 114(b)(4) of the code is amended to include a definition of "gross income from the property" for purposes of percentage depletion of mines. It also defines the scope of income from mining for the purposes of section 731 and section 735. *The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines.* [Italics supplied.]

The law has never contained such a definition, and its absence has given rise to numerous disputes. *The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the* [24] *Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions.* [Italics supplied.]

* * * * *

[39] DETAILED DISCUSSION OF THE TECHNICAL PROVISIONS OF THE BILL

TITLE 1.—INDIVIDUAL AND CORPORATION INCOME TAXES

* * * * *

[54]

* * * * *

SEC. 117. Percentage Depletion for Flake Graphite, Vermiculite, Potash, Beryl, Feldspar, Mica, Talc, Lepidolite, and Spodumene.

This section is substantially similar to section 114 of the House bill but differs in some respects as hereinafter discussed.

Subsection (a) of this section amends the heading and the first sentence of section 114(b)(4), relating to percentage depletion for coal, fluorspar, ball and sagger clay, rock asphalt, and metal mines, and sulphur, so as to include among the mines or deposits entitled to percentage depletion flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, and potash. The provision relating to talc was not in the House bill. In the case of flake graphite, vermiculite, potash, beryl, feldspar, mica, talc, lepidolite, and spodumene mines, the allowance for depletion shall be 15 percent of the gross income from the property during the taxable year, excluding from such gross

income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. This allowance is subject to the further limitations contained in the existing provisions of section 114(b)(4). The provision in the House bill fixing the allowance in the case of potash at 23 percent has been eliminated.

Subsection (b) amends section 114(b)(2) relating to discovery value of certain mines, so as to debar the use of the discovery value as the basis for depletion in the case of flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, and potash mines. As noted above, talc was not included in the House bill provision.

[55] Subsection (c), which was not in the House bill, adds a new subparagraph (B) to section 114(b)(4) of the code to define for the purposes of section 114(b)(4) the term "gross income from the property." For such purposes the term "gross income from the property" means the gross income from mining. The term "mining" shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. It is further provided that the term "ordinary treatment processes," as so used, shall include the following:

(1) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (2) in the case of sulfur—pumping to vats, cooling, breaking, and loading for shipment; (3) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for ship-

ment; and (4) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, precipitation (but not including electrolytic deposition), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The costs of any process or service which does not constitute an "ordinary treatment process" shall be excluded in the determination of such gross income from mining. Provision is also made that the principles of this subparagraph shall be applicable in determining gross income attributable to mining for the purposes of section 731 of the code (relating to corporations engaged in mining of strategic minerals) and section 735 of the code (relating to nontaxable income from certain mining and timber operations).

Subsection (d) provides that the amendments made by subsections (a) and (b), insofar as they apply to flake graphite mines, shall be applicable to taxable years beginning after December 31, 1942.

Subsection (e) of the House bill provides that the amendments made by subsections (a) and (b) and the amendments made to section 114 of the code by section 145 of the Revenue Act of 1942, providing percentage depletion for fluorspar, ball and sagger clay, and rock asphalt, shall not be applicable to any taxable year beginning on or after the date of the termination of hostilities. Your committee has amended this subsection to provide that the termination date applicable to the minerals specified in subsections (a) and (b) shall not be applicable in the

case of potash. Your committee has also provided that the amendment made by subsection (c) of this section shall be effective as if it were a part of the Internal Revenue Code and the Revenue Acts of 1938, 1936, 1934, and 1932, as of the effective date of the code and as of the date of enactment of each of the respective acts.

Senate Debate, 1944

(90 Cong. Record (Part 1), 78th Cong., 2d Sess.)

[85] THE REVENUE ACT

The Senate resumed the consideration of the bill (H.R. 3687) to provide revenue, and for other purposes.

* * * * *

[99]

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The next amendment was, on page 59, in line 12, after the word "sulphur", to strike out "or potash", and in line 21, after the word "mica", to insert "talc."

The amendment was agreed to.

The next amendment was, on page 59, after line 21, to insert:

> (c) Definition of gross income from the property: Section 114(b)(4) is amended by adding at the end thereof the following:
>
> (B) Definition of gross income from property: As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining," as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term "ordinary treatment processes," as used

herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulfur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar [100] ores, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, precipitation (but not including electrolytic deposition), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. In the determination of such gross income from mining, there shall be excluded the costs of any process or service which does not constitute an ordinary treatment process. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 731 and 735.

Mr. HATCH. Mr. President, I send to the desk an amendment to the committee amendment, which I offer and ask to have stated. It has the same purpose, that of merely clarifying and correcting what appear to be technical errors.

The PRESIDING OFFICER. The amendment to the amendment will be stated.

The CHIEF CLERK. To the committee amendment, on page 60, in line 21, before the word "and", it is proposed to insert the word "potash."

The PRESIDING OFFICER. The question is on agree-

ing to the amendment offered by the Senator from New Mexico to the committee amendment.

The amendment to the amendment was agreed to.

Mr. HATCH. Mr. President, I offer and send to the desk another amendment to the committee amendment on page 60. The amendment is of the same nature as the former one. *It would merely add the word "crystallization," a change which is a matter of technical wording.* [Italics supplied.]

The PRESIDING OFFICER. The amendment offered by the Senator from New Mexico to the committee amendment will be stated.

The CHIEF CLERK. At the end of the committee amendment on page 60, in line 25, it is proposed to insert the word "crystallization" and a comma.

The PRESIDING OFFICER. The question is on agreeing to the amendment of the Senator from New Mexico to the committee amendment.

The amendment to the amendment was agreed to.

The PRESIDING OFFICER. The question is on agreeing to the committee amendment as amended.

The amendment as amended was agreed to.

* * * * *

Mr. HATCH. Mr. President, some time ago I submitted an amendment and asked that it be referred to the Committee on Finance. It related primarily to potash. The committee adopted a part of the amendment which I submitted. However, the amendment which I submitted included two sections. I did not argue before the committee the second section, which reads as follows:

> (c) Income from potash mines or deposits: Section 114(b)(4) is amended by adding at the end thereof the following sentence: "In the case of potash, whether extracted from a mine or from a brine or other deposit, there shall be

included in gross and net income from the property the income from other minerals or mineral salts extracted therefrom."

* * * * *

Mr. GEORGE. I am not familiar with it. I am willing to take it to conference, with the understanding that we shall there have the right fully to examine it.

Mr. HATCH. That is satisfactory.

The PRESIDING OFFICER. The amendment offered by the Senator from New Mexico will be stated.

* * * * *

The PRESIDING OFFICER. The question is on agreeing to the amendment offered by the Senator from New Mexico [Mr. HATCH].

The amendment was agreed to.

The PRESIDING OFFICER. The question is on agreeing to the committee amendment on page 61, line 25.

The amendment was agreed to.

* * * * *

[194] Mr. MCCLELLAN. Mr. President, I ask unanimous consent to return to pages 58 and 59 of the bill, section 117, I offer the amendments which I send to the desk and ask to have read.

The PRESIDING OFFICER. Without objection, the amendments will be stated.

The CHIEF CLERK. The following amendments are proposed:

On page 58, lines 20 and 21, strike out "and spodumene" and insert "spodumene, and barite."

On page 59, line 5, after "spodumene", insert "barite."

On page 59, line 11, after "spodumene", insert "barite."

On page 59, line 21, after "spodumene", insert "barite,"

Mr. McCLELLAN. Mr. President, the amendments, or substantially these, were presented by me to the Finance Committee. That was in the closing days of the committee's consideration of the bill, and the matter had come to my attention only at that time. The committee suggested that I secure from the War Production Board a statement or certificate with respect to this mineral and its importance—in other words, the War Production Board's recommendation regarding whether it should be included along with other minerals and metals which now are included in subsection 4 of section 117 of the pending bill, to receive the benefit of percentage depletion.

I immediately took up the matter with the War Production Board, and was advised by letter of December 21, the letter being written by Mr. Harry J. Wolf, chief of the Cadmium-Indium Section, Zinc Division, of the War Production Board. * * *

* * * * *

[195] Mr. GEORGE. Mr. President, I will not object to the amendement, because the letter submitted by the distinguished junior Senator from Arkansas, which he received from the War Production Board, is unusually strong.

There has been opposition by many members of the committee to the inclusion of certain minerals in the provision with respect to the depletion allowance. It is questionable whether the policy on which we have embarked is sound, but the House has included several new metals and minerals and given them a depletion allowance. The Senator from Arkansas has certainly made a meritorious case in this particular instance. I will not offer any objection to the amendement.

The PRESIDING OFFICER. The question is on agreeing to the amendment offered by the Senator from Arkansas [Mr. McCLELLAN].

The amendment was agreed to.

* * * * *

H. Conference Rep. No. 1079

(78th Cong., 2d Sess. (1944 Cum. Bull. 1059))

[20] * * * * *

Amendment numbered 47: That the House recede from its disagreement to the amendment of the Senate numbered 47, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

[21] (c) DEFINITION OF GROSS INCOME FROM THE PROPERTY.—*Section 114(b)(4) is amended by adding at the end thereof the following:*

"(B) Definition of Gross Income From Property.—As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term 'ordinary treatment processes', as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulfur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing,

grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 731 and 735."

And the Senate agree to the same.

Amendment numbered 49: That the House recede from its disagreement to the amendment of the Senate numbered 49, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert A *provision having the effect of the amendment made by subsection (c) shall be deemed to be included in the revenue laws respectively applicable to taxable years beginning after December 31, 1931.;* and the Senate agree to the same.

* * * * *

[40] STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE:

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 3687) to provide revenue, and for other purposes, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

* * * * *

[50]

* * * * *

Amendments Nos. 37, 38, 39, 41, 42, 45, and 46. These amendments made to section 114 of the House bill include talc and barite in the list of mines which are entitled to depletion at the rate of 15 percent of the gross income from the property (subject to other limitations in the code), and exclude talc and barite from the list of mines entitled to depletion based on discovery value. These amendents do not apply with respect to any taxable year beginning on or after the date of the termination of hostilities in the present war, as defined in subsection (e) of this section. The House recedes as to these amendments with a clerical amendment to amendment No. 37 changing the section heading.

Amendments Nos. 40, 48, and 50: These are clerical amendments. The House recedes as to these amendments with a clerical change in amendment No. 40.

Amendments Nos. 43, 44, and 51: Under section 114 of the House bill, potash mines and deposits were allowed percentage depletion in an amount equal to 23 percent of the gross income from the property (subject to other limitations in the code), and were excluded from the list of mines entitled to discovery value depletion; these provisions were not to be applicable to any taxable year beginning on or after the date of the termination of hostilities in the present war. These amendments provide that potash mines or deposits shall be allowed [51] depletion based upon 15 percent of the gross income from the property, instead of 23 percent, and remove the restriction contained in the House bill which would make inapplicable such allowance for taxable years beginning on or after the date of the termination of hostilities in the present war. It is contemplated that the regulations to be issued by the Commissioner will

provide that potash salts in solution are deemed to be a natural deposit. The House recedes.

Amendments Nos. 47 and 49: For the purposes of section 114(b)(4) of the code amendment No. 47 defines the term "gross income from the property" upon which is based the allowance for percentage depletion. Thus "gross income from the property" means gross income from "mining," and "mining" is considered to include the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products as well as the extraction of the ores or minerals from the ground. *The costs of any process or service which does not constitute an ordinary treatment process is to be excluded in determining gross income from mining.* Several specified processes have been listed as being included in the term "ordinary treatment processes." The principles set forth in this amendment are made expressly applicable to mining for the purposes of sections 731 and 735 of the code. Amendment No. 49 makes amendment No. 47 effective as if it were a part of the Internal Revenue Code and the Revenue Acts of 1938, 1936, 1934, and 1932 on the date of their respective enactments. *The House recedes with amendments which strike out the next to the last sentence of the subparagraph added by amendment No. 47, which provided that the costs of any process or service which does not constitute an ordinary treatment process is to be excluded in determining gross income from mining, and with an amendment excluding electrolytic deposition, roasting, thermal or electric smelting and refining from the definition of "ordinary treatment processes"* and which rephrase the retroactivity provisions in amendment No. 49. [Italics supplied.]

Amendment No. 52: This amendment, for which there is no corresponding provision in the House bill,

provides that, in computing percentage depletion under section 114(b)(4) of the code in the case of potash (whether extracted from a mine or from a brine or other deposit), there shall be included in gross and net income from the property the income from other minerals or mineral salts extracted from such property. The Senate recedes.

* * * * *

Revenue Act of 1943

(c. 63, 58 Stat. 21, 44)

SEC. 124. PERCENTAGE DEPLETION FOR FLAKE GRAPHITE, VERMICULITE, POTASH, BERYL, FELDSPAR, MICA, TALC, BARITE, LEPIDOLITE, AND SPODUMENE.

(a) *In General.*—So much of section 114(b)(4) (relating to percentage depletion for certain minerals) as precedes the second sentence thereof is amended to read as follows:

> (4) *Percentage Depletion for Coal, Fluorspar, Flake Graphite, Vermiculite, Beryl, Feldspar, Mica, Talc, Lepidolite, Spodumene, Barite, Ball and Sagger Clay, Rock Asphalt, and Metal Mines, Potash, and Sulphur.*—
>
> (A) *In General.*—The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, fluorspar, flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, barite, ball and sagger clay, or rock asphalt mines, and potash mines or deposits, 15 per centum, and in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property.

(b) *Discovery Value.*—Section 114(b)(2) (relating to discovery value) is amended by inserting after

"fluorspar" the following: "flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, barite, potash,".

(c) *Definition of Gross Income From the Property.*—Section 114(b)(4) is amended by adding at the end thereof the following:

(B) *Definition of Gross Income From Property.*—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product

or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 731 and 735.

(d) *Percentage Depletion for Flake Graphite Retroactive to 1943.*—The amendments made by subsections (a) and (b) inserting flake graphite in section 114(b) (2) and (4) of the Internal Revenue Code shall be applicable with respect to taxable years beginning after December 31, 1942. A provision having the effect of the amendment made by subsection (c) shall be deemed to be included in the revenue laws respectively applicable to taxable years beginning after December 31, 1931.

(e) *Termination of Percentage Depletion for Certain Minerals.*—The amendments made by subsections (a) and (b) (except as they relate to potash) and the amendments made to section 114 of the Internal Revenue Code by section 145 of the Revenue Act of 1942 (providing percentage depletion for fluorspar, ball and sagger clay, and rock asphalt), shall not apply with respect to any taxable year beginning on or after the date of the termination of hostilities in the present war. For the purposes of this subsection the term "date of the termination of hostilities in the present war" means the date proclaimed by the President as the date of such termination, or the date specified in a concurrent resolution of the two Houses of Congress as the date of such termination, whichever is the earlier.

(Effective for years beginning after December 31, 1941, as first amended after passage of 1943 Act)

SEC. 29.23(m)–1 [as amended by T.D. 5413, approved October 31, 1944 (1944 Cum. Bull. 124)]. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*—Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

* * * * *

When used in these sections (29.23(m)–1 to 29.23(m)–28, inclusive) covering depletion and depreciation—

* * * * *

(d) "Minerals" include ores of the metals, coal, oil, gas, and such nonmetallic substances as abrasives, asbestos, asphaltum, *barite, beryl,* borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth, graphite, gravel, gypsum, *lepidolite,* limestone, magnesite, marl, mica, mineral, pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, *spodumene,* sulphur, talc, *and vermiculite.* [Italics supplied.]

* * * * *

(f) *The term* "gross income from the property," as used in sections 114(b)(3) and *114(b)(4)(A)* and sections 29.23(m)–1 to 29.23(m)–28, inclusive, means the *following:*

In the case of oil and gas wells, "gross income from

the property" as used in section 114(b)(3) means the amount for which the taxpayer sells the oil and gas in the immediate vicinity of the well. If the oil and gas are not sold on the property but are manufactured or converted into a refined product prior to sale, or are transported from the property prior to sale, the gross income from the property shall be assumed to be equivalent to the representative market or field price (as of the date of sale) of the oil and gas before conversion or transportation.

In the case of a crude mineral product other than oil and gas, "gross income from the property", as used in section 114(b)(4)(A) means the gross income from mining. The term "mining" as used herein includes not only the extraction of ores or minerals from the ground but also the ordinary treatment processes which are normally applied by the mine owners or operators to the crude mineral product after extraction in order to obtain the commercially marketable mineral product or products. [Italics supplied.]

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, *"gross income from the property" means the amount for which* such product was sold, but, if the product is transported or processed (other than by the *ordinary treatment processes described* below) before sale, *"gross income from the property"* means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as *beneficiated by the ordinary treatment processes actually applied,* before transportation *of such product.* If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in

its crude *mineral* state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation and the processes *beyond the ordinary treatment processes.* [Italics supplied.]

The term "ordinary treatment processes," as used herein, shall include the following:

(1) In the case of coal—cleaning, breaking, sizing, and loading for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment;

(3) In the case of iron ore, *bauxite,* ball and sagger clay, rock asphalt, and *minerals* which are customarily sold in the form of a crude mineral product—sorting, concentrating, *and sintering* to bring to shipping grade *and form,* and loading for shipment;

(4) In the case of lead, zinc, copper, gold, silver, or fluorspar ores, *potash,* and ores which are not customarily sold in the form of the crude mineral product—crushing, *grinding and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore. The furnacing of quicksilver ores is included in the term "ordinary treatment processes." The following processes are not included in the term "ordinary treatment processes"; electrolytic deposition, roasting, thermal or electric smelting, refining, or substantially equivalent processes.* [Italics supplied.]

In case any of the *ordinary treatment* processes are not applied in the immediate vicinity of the mining district in which the mine is located, costs incurred for transportation to the processing location and, if transported by the taxpayer, the proportionate profits

attributable to transportation, should be subtracted from the sale price of the product to determine "gross income from the property."

* * * * *

(g) "Net income of the taxpayer (computed without allowance for depletion) from the property," as used in section 114(b)(2), (3), and (4) and sections 29.23(m)-1 to 29.23(m)-28, inclusive, means the "gross income from the property" as defined in paragraph (f) of this section less the allowable deductions attributable to the mineral property upon which the depletion is claimed and the allowable deductions attributable to the processes listed in paragraph (f) in so far as they relate to the product of such property, including overhead and operating expenses, development costs properly charged to expense, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. Deductions not directly attributable to particular properties or processes shall be fairly allocated. To illustrate: In cases where the taxpayer engages in activities in addition to mineral extraction and to the processes listed in paragraph (f), deductions for depreciation, taxes, general expenses, and overhead, which cannot be directly attributed to any specific activity, shall be fairly apportioned between (1) the mineral extraction and the processes listed in paragraph (f) and (2) the additional activities, taking into account the ratio which the operating expenses directly attributable to the mineral extraction and the processes listed in paragraph (f) bear to the operating expenses directly attributable to the additional activities. If more than one mineral property is involved, the deductions apportioned to the mineral extraction and the processes listed in paragraph (f) shall, in turn, be fairly apportioned to the several

properties, taking into account their relative production.

(h) "Crude mineral product," as used in paragraph (f) of this section, means the product in the form in which it emerges from the mine or well.

1945

T.D. 5461

(Approved July 9, 1945 (1945 Cum. Bull. 284))

[This added the following sentence to Treasury Regulations 111, Section 29.23(m)-1(f)]

> If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

1947

[The Act of August 8, 1947, c. 515, 61 Stat. 917, Section 15, repealed the provision limiting percentage depletion for certain non-metallics to the war-time period, and added certain other non-metallics to the list for which percentage depletion was allowed. Passage of the Act was preceded by a House hearing in which several mining industries were represented. The portions of their statements relating to the processes applied by the industry to the particular mineral are included in Part B of this appendix, but the proceedings leading up to the passage of the Act are otherwise given below in chronological order.]

(Percentage Depletion, Hearing before the Committee on Ways and Means, House of Representatives, 80th Cong., 1st Sess., on H.R. 1993 (1947))

* * * * *

[1] Statement of MALCOLM TARVER, representing the Committee on Taxation, Barite Industry of the United States:

* * * * *

[2] The bills seek to renew the provisions of section 124 of the Revenue Act of 1943, relating to the depletion tax credit for nonmetallic ores.

It is, of course, unnecessary that I should undertake to discuss before members of this committee, which has studied this question and accorded it consideration throughout the years, the technical features which are involved in this proposition.

I do wish, however, to point out to you certain salient facts which to my mind constitute incontrovertible arguments in favor of the enactment of this legislation.

* * * * *

[11] Mr. SIMPSON. Judge Tarver, have you any figures to indicate approximately how much per ton this depletion allowance may amount to, allowed by the tax laws at the present time?

Mr. TARVER. The cost of production, f.o.b. the mines, is approximately $8 per ton, and the 15 percent depletion allowance is *upon the gross value of production, as I understand it.* (Italics supplied.)

* * * * *

[14] Statement of WESLEY E. DISNEY, Tulsa, Okla., representing the talc, fluorspar, and thenardite interests:

* * * * *

I would like to stress one thing that Judge Tarver referred to, and that is the question of discrimination. [15] Every one of these items, except thenardite, which is mined in a manner similar to sulfur—every one of these nonmetallics is a mining operation.

All of the mineral ores have percentage depletion of 15 percent. Very little dissimilarity in the operation of producing and processing these ores to the mining and processing of the minerals that all enjoy a 15-percent depletion under long-existing statutes exists.

* * * * *

[18] Mr. DISNEY. As I said, I do not want to take the committee's time. Let me make quick reference to fluorspar for a moment.

It was given permanent depletion through the 1942 act, and through some error it got into the termination clause.

* * * * *

Mr. LYNCH. This talc and the other mineral interests that you represent here—as I understand it, they are all mined, are they not?

Mr. DISNEY. Talc and fluorspar, yes; they are mined.

Mr. LYNCH. It is a mining operation?

Mr. DISNEY. Yes. The operation for that thenardite is similar to the sulfur operation.

Mr. LYNCH. What you are asking for here in reality is to have the same treatment afforded to these particular interests as has been accorded to other metals or other ores?

Mr. DISNEY. Yes, sir, as they were up to the 1st of last January, and mineral ores have been accorded that type of treatment for many years, including coal.

Mr. LYNCH. *So there is no change in principle here?* [Italics supplied.]

Mr. DISNEY. *None whatever.* [Italics supplied.]

Mr. LYNCH. *It is just applying the old principle to these minerals which previously had this depletion percentage?* [Italics supplied.]

Mr. DISNEY. *Yes;* they had it. Fluorspar had it from 1942 up until the 1st of last January, and the others from 1943 to 1946, inclusive. [Italics supplied.]

Mr. LYNCH. *Aside from the time period, the principle is just the same?* [Italics supplied.]

Mr. DISNEY. *It is exactly the same.* [Italics supplied.]

Mr. LYNCH. *It is the same with respect to these minerals as with respect to oil and other minerals which have percentage depletion?* [Italics supplied.]

Mr. DISNEY. *That is true sir.* [Italics supplied.]

* * * * *

[25] Statement in support of percentage depletion for talc producers before the Ways and Means Committee of the House of Representatives, June 4, 1947:

My name is HENRY MULRYAN of Glendale, Calif. * * *

* * * * *

I wish to present a brief description of talc, how and where it is mined, its characteristics and uses, and why its producers should have the benefit of percentage depletion made a permanent part of the income tax law.

* * * * *

[27] There are numerous reasons why percentage depletion should be permanent for talc. The industry fails to see any essential difference between the mining of nonmetallic minerals and metallic minerals and is even more certain there should be no discrimination between talc and the other nonmetallic miner-

als which have long had percentage depletion. We have no objection or argument against percentage depletion for other minerals; in fact, it is the only feasible means of permitting the producers a return of capital. Is there some reason why this method should be granted to coal, sulfur, and potash and not to talc?

* * * * *

[42] Statement of JOHN BISHOP, Chicago, Ill., representing the vermiculite interests:

* * * * *

[44] Vermiculite is the basic mineral from which the income of processors, fabricators, and dealers is derived. In this respect, it is comparable to iron, copper, or lead sold by mine owners or operators to furnaces and smelters. Just as the ores are sent to furnaces and smelters whose products are in turn sold to fabricators for the manufacture of countless articles of commerce, so vermiculite is sold to processors and fabricators to make therefrom a large variety of commercial products.

Basic metals such as iron, copper, and lead are permitted percentage depletion. Vermiculite occupies the same position in the nonmetallic industry. It should therefore be accorded the same depletion.

* * * * *

H. Rep. No. 802

(80th Cong., 1st Sess. (1947-2 Cum. Bull. 353))

[1] GENERAL STATEMENT

The purpose of this bill is to provide for the termination of a number of war and emergency statutory provisions related to internal revenue and customs. The bill also makes amendments to the Internal Rev-

enue Code appropriate in connection with the termination of certain of the statutes.

INTERNAL REVENUES

* * * * * *

[2] Percentage depletion was allowed certain minerals during the war period. The minerals affected are ball and sagger clay, fluorspar, and rock asphalt provided for under the Revenue Act of 1942, and barite, beryl, feldspar, flake graphite, mica, lepidolite, spodumene, talc, and vermiculite provided for under the Revenue Act of 1943. These allowances were terminated with respect to taxable years beginning after December 31, 1946, the date proclaimed by the President as the date of termination of hostilities in World War II.

Your committee, after hearings on the subject, is of the opinion that such allowances should be continued for taxable years beginning after December 31, 1946, and also that percentage depletion should be allowed in the case of china clay, bentonite, gilsonite, and thenardite for taxable years beginning after December 31, 1946. Accordingly, the bill eliminates the existing provisions providing for such termination and allows percentage depletion for the four additional items last mentioned for the years specified.

* * * * * *

[3] DETAILED DISCUSSION OF THE TECHNICAL PROVISIONS OF THE BILL.

* * * * * *

[9] SECTION 15—PERCENTAGE DEPLETION

Section 15 by amendment to section 114 of the Internal Revenue Code and by repeal of section 124(e) of the Revenue Act of 1943 continues in effect, as permanent legislation, the wartime allowance of percentage depletion at the rate of 15 percent in the case of

the following minerals: Fluorspar, flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, barite, ball and sagger clay, and rock asphalt. Section 15 also adds china clay, bentonite, gilsonite, and thenardite.

Pursuant to the provisions of section 124(e) of the Revenue Act of 1943 and the President's proclamation of December 31, 1946, declaring hostilities in World War II terminated, the provisions of section 114 of the code regarding percentage depletion as to the items named above (except china clay, bentonite, gilsonite, and thenardite) ceased to be applicable with respect to taxable years beginning after December 31, 1946. Section 15 repeals section 124(e) of the Revenue Act of 1943 as of the date of its enactment and further provides that the amendments made to section 114 of the code shall be applicable with respect to taxable years beginning after December 31, 1946. The effect of this is that the percentage depletion rules as to the minerals named in existing law continue without change, and percentage depletion is allowable in the case of china clay, bentonite, gilsonite, and thenardite for taxable years beginning after December 31, 1946.

House Debate, 1947

(93 Cong. Record (Part 8), 80th Cong., 1st Sess.)
(1947)

[9626] TERMINATING CERTAIN TAX PROVISIONS

Mr. KNUTSON. Mr. Speaker, I move to suspend the rules and pass the bill (H.R. 4069) to terminate certain tax provisions before the end of World War II.

The Clerk read as follows:

* * * * *

[9627]

* * * * *

SEC. 15. Percentage Depletion

* * * * * *

Mr. KNUTSON. * * *

* * * * *

[9628]

* * * * *

On the question of percentage depletion allowances, the committee considered this subject in detail. Public hearings were held, at which both sides of the question had full opportunity to present their views.

* * * * *

Each of these products, including those added to the list by H.R. 4069 is an essential *raw material* badly needed in times of peace as well as in time of war. The products added by H.R. 4069 are ball and sagger clay, china clay, or Kaolin, bentonite, gilsonite and thenardite, or sodium sulphate. [Italics supplied.]

These products were added because the mining problems involved are similar and in some cases identical with the problems faced by producers of petroleum, coal, and minerals. The deposits of the new products added by the bill are known in some cases, but unknown in others. Yet the producers must constantly explore new fields to determine their commercial value or the existence of new deposits. The depletion allowance encourages this explorative work. It is an expensive process, Mr. Speaker, and one that cannot be avoided. Unless we make a proper tax adjustment in the case of these mining operations we will discourage, if not prevent, discovery of new sources. Obviously, we cannot afford to do that.

* * * * *

S. Rep. No. 693

(80th Cong., 1st Sess., to accompany H.R. 4069 (1947-2 Cum. Bull. 359))

[1]

* * * * *

The Committee on Finance, to whom was referred the bill (H.R. 4609) to terminate certain tax provisions before the end of World War II, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

With the exception of committee amendments to sections 5, 7, 8, and 15, of the bill, and the addition by your committee of a section 16 to the bill, the bill is the same as passed by the House. The report of the Committee on Ways and Means on the bill is attached hereto as appendix A. A detailed explanation of the bill (which, except with respect to the committee amendments, is equally applicable to the bill as reported by your committee) is included in the House report.

* * * * *

[2]

* * * * *

Section 15 of the House bill provided that the wartime provision for percentage depletion in the case of certain minerals should be continued as permanent legislation, and further provided for percentage depletion in the case of china clay, bentonite, gilsonite, and thenardite for taxable years beginning after December 31, 1946. Your committee amendment to this section of the bill adds pyrophyllite and trona to the list of minerals for which percentage depletion is allowable for taxable years beginning after December 31, 1946.

* * * * *

H. Conference Rep. No. 1097

80th Cong., 1st Sess. (July 25, 1947) (1947-2 Cum. Bull. 360)

[2] STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE:

* * * * *

[3]

* * * * *

Amendment No. 10: This amendment provides for percentage depletion at the rate of 15 percent in the case of bauxite for taxable years beginning after December 31, 1946. The House recedes.

Amendment No. 11: This amendment provides for percentage depletion at the rate of 15 percent in the case of pyrophylite for taxable years beginning after December 31, 1946. The House recedes.

Amendment No. 12: This amendment provides for percentage depletion at the rate of 15 percent in the case of phosphate rock for taxable years beginning after December 31, 1946. The House recedes.

Amendment No. 13: This amendment provides for percentage depletion at the rate of 15 percent in the case of trona for taxable years beginning after December 31, 1946. The House recedes.

Amendment No. 14: This amendment provides, with respect to percentage depletion, that—

> In the case of potash and thenardite, whether extracted from a mine or from a brine or other deposit, there shall be included in gross and net income from the property the income from other minerals or mineral salts extracted therefrom.

The Senate recedes.

* * * * *

SEC. 15. PERCENTAGE DEPLETION.

(a) Section 124(e) of the Revenue Act of 1943 (relating to termination of percentage depletion for certain minerals) is repealed as of the date of its enactment.

(b) So much of section 114(b)(4) of the Internal Revenue Code (relating to percentage depletion for certain minerals) as precedes the second sentence thereof, is amended to read as follows:

> (4) *Percentage Depletion for Coal, Bauxite, Fluorspar, Flake Graphite, Vermiculite, Beryl, Feldspar, Mica, Talc (Including Pyrophyllite), Lepidolite, Spodumene, Barite, Ball, Sagger, and China Clay, Rock Asphalt, Phosphate Rock, Trona, Bentonite, Gilsonite, Thenardite, and Metal Mines, Potash, and Sulfur.*—
>
> (A) *In General.*—The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, bauxite, fluorspar, flake graphite, vermiculite, beryl, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball, sagger, and china clay, phosphate rock, rock asphalt mines, trona, bentonite, gilsonite, thenardite (from brines or mixtures of brine), and potash mines or deposits, 15 per centum, and in the case of sulfur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property.

(c) The first sentence of section 114(b)(2) of the Internal Revenue Code (relating to discovery value) is amended to read as follows:

> In the case of mines (other than metal, bauxite, coal, fluorspar, flake graphite, vermiculite,

beryl, feldspar, mica, talc (including pyhophyllite), lepidolite, spodumene, barite, potash, ball, sagger, and china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, or sulfur mines) discovered by the taxpayer after February 28, 1913, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost.

(d) The amendments made by subsections (b) and (c) of this section shall be applicable with respect to taxable years beginning after December 31, 1946.

1947–1948

[In hearings the mining industry recommended clarification of the definition of *net* income from the property, but no action was taken by Congress.]

House Hearings, 1947

(Revenue Revisions, 1947–48, Hearings before the Committee on Ways and Means, House of Representatives, 80th Cong., 1st Sess. (1947))

[Part 3]

* * * * *

[1855] Statement on behalf of the mining industry presented to the Committee on Ways and Means of the House of Representatives by H. B. FERNALD, chairman, tax committee, and JULIAN D. CONOVER, secretary, American Mining Congress, July 1947:

The following statement is presented by the tax committee of the American Mining Congress to set forth its recommendations for certain changes which should be made in the Revenue Code in the interest of fair and equitable treatment of the mining industry.

Certain of these recommendations relate to problems peculiar to the mining industry, while others are with respect to matters of great importance to the mining industry but which also affect other industries.

* * * * * *

[1856] A. Special Mining Problems

Under this division we present certain matters which relate particularly to mining. The essence of mining is that its current operations necessarily represent a continual realization upon its capital assets. It realizes its gains only as it depletes its capital reserves. Its sales necessarily involve the sale of capital assets. Our tax laws have generally recognized the principle that a gain realized on the disposition of capital assets should be taxed at a lower rate than may be applied to recurring ordinary income. This principle is directly recognized in realization upon the sale of timber. For mining, we have over a long series of years worked out a different plan which allows, as an annual deduction, depletion based on cost (or on March 1, 1913 value), discovery depletion and percentage depletion. These provisions have repeatedly been considered at great length by Congress, and each time Congress has been satisfied that the present plan gives no more than a reasonable allowance for depletion for the mining industry.

* * * * * *

We therefore urge that present depletion provisions not be changed in any way which would make them less favorable to the mining industry.

[1857] On the other hand, there are many problems connected with the mining industry and its depletion which need better and clearer statement in the law, to simplify and make more certain the interpretations involved, and to prevent abstruse and difficult prob-

lems and computations which under the Bureau's administration are now being raised. *We believe there are none of our recommendations which depart from the original intent of these provisions or from the Bureau's practice of earlier years.* [Italics supplied.]

We accordingly present the following recommendations regarding special mining problems:

1. *Definition of "net income from the property" for purpose of percentage depletion.*

There is need for writing into the law a definition of "net income from the property" as that phrase is used in section 114(b)(4) of the code, which imposes the limitation that percentage depletion for mines "shall not exceed 50 percentum of the net income of the taxpayer (computed without allowance for depletion) from the property * * *." The provisions of the law relating to percentage depletion of mines, as first enacted in 1932 and subsequently reenacted without change in this regard, have not defined this wording. It was first defined in regulations 77, article 221 (h) which definition, substantially unchanged, has been continued through subsequent regulations and is section 29.23(m)-1(g) of regulations 111. It is believed that the original regulations were intended fairly to express the congressional intent, but administrative practices within the Bureau have gradually developed to reduce the amount of "net income from the property" below the amount which under earlier practices was considered allowable. The courts have generally tended to support administrative determinations where the law is not definite in prescribing its basis. To make clear the intent of Congress and give the taxpayer protection, it seems necessary that the law should adequately define this phrase.

* * * * * *

The proposed definition is intended to simplify the computations and limit the deductions to those items which have a direct bearing upon the production of income from the particular property on which the percentage depletion is allowable.

We accordingly recommend the following amendment:

Add to section 114(b)(4) a new subparagraph, (C), as follows:

"(C) Definition of Net Income from the Property—As used in this paragraph the term 'net income from the property' means the gross income from the *minerals* from the property, less the allowable deductions directly attributable to the mineral property upon which the depletion is claimed and *the allowable deductions directly attributable to the processes listed in paragraph (B) of this subsection insofar as they relate to the products of such property,* including operating expenses, development costs properly chargeable to expense, depreciation, property taxes, losses sustained, etc., but excluding any allowance for depletion. Such expenses or deductions shall not include expenses or deductions attributable to, or arising out of expenditures on, other property or assets, irrespective of whether such property or assets are income producing or active. Deductions not attributable to, or arising out of particular properties, processes or assets, such as general [1858] overhead, shall be fairly allocated to all properties, processes, and assets whether active or inactive. The term 'general overhead' as used herein shall be deemed to mean the overhead relating to the property but shall exclude deductions and expenses of financial overhead of the taxpayer such as interest, taxes based on or measured by income, capital stock taxes, and the like. If more than one active mineral property is involved, the de-

ductions apportioned to the mineral extraction in the processes listed in paragraph (B) of this subsection shall in turn be fairly apportioned to the several properties, taking into account their relative production." [Italics supplied.]

* * * * *

This amendment, as an expression of congressional intent, should be given retroactive effect.

* * * * *

[Part 5]:

[3281]

* * * * *

Statement of L. H. PARKER on behalf of the Special Committee on Taxation, National Coal Association, Washington, D.C.:

Mr. PARKER. * * *

* * * * *

[3282]

* * * * *

Thank you, Mr. Chairman, and I file this statement for the record.

Mr. WOODRUFF. That will be included as a part of your remarks, Mr. Parker.

(The statement referred to is as follows:)

Technical Amendments to the Internal Revenue Code Suggested by the Special Committee on Taxation, National Coal Association, Washington, D.C.

There are submitted herewith three suggested amendments to the Internal Revenue Code, with explanations. It it believed all of these amendments clarify existing law.

The first suggestion is that a definition of net income from the property be included in the code. Such a definition is now lacking.

* * * * *

[The Technical Changes Act of 1949, c. 720, 63 Stat. 891, did not amend existing law relating to percentage depletion, but an amendment passed by the Senate would have extended percentage depletion to several additional minerals. The Congressional reports, together with a brief excerpt from the Senate debate, follow.]

S. Rep. No. 831

(81st Cong., 1st Sess. (1949–2 Cum. Bull. 289))

* * * * *

[9] 9. *Percentage depletion for perlite and diatomaceous earth.*

Section 9, which was not contained in the House bill, amends section 114(b) of the Internal Revenue Code to provide a different basis for allowance of depletion in the case of mines or deposits of perlite and diatomaceous earth. The effect of the amendments made by this section of the bill is to add mines or deposits of perlite and diatomaceous earth to the list of nonmetallic mines or deposits which are allowed depletion in the amount of 15 percent of the gross income derived therefrom, and to make inapplicable to these mines or deposits the allowance of depletion upon the basis of discovery value. It is proposed to allow percentage depletion only with respect to perlite and diatomaceous earth in the dried crude mineral form, before grinding or any other preparation for any particular market. Periite is a volcanic glass, and diatomaceous earth, a chalk-like, or clay-like material which is the slicified skeleton remains of colonial algae.

The Director of the Bureau of Mines reports that although the Bureau does not have a detailed statistical record which would completely define the degree of competition of these minerals with those now accorded

percentage depletion, "such competition is known to exist." He further reports:

> For example, diatomaceous earth is used as a heat-insulating material and as such competes with vermiculite in some applications. Diatomaceous earth is also used as a filler in a wide variety of products, and therefore competes in varying degree with other minerals that serve this market, such as china clay, bentonite, talc, and barite, all of which are allowed percentage depletion.
>
> [10] Similarly, perlite competes with vermiculite in the lightweight aggregate market.

Other reports indicate that perlite or diatomaceous earth, or both are also competitive with ball and sagger clay, feldspar, mica, and pyrophyllite. Since all of these minerals, as well as those mentioned above by the Director of Mines, receive percentage depletion, your committee believes that the benefits of percentage depletion should also be extended to perlite and diatomaceous earth to remove any tax differential which might prevent them from competing on an equal basis with these other minerals.

It is not proposed to allow percentage depletion with respect to the value added as the result of grinding or other special preparation because many of the extractors do not themselves carry on this process, but rather sell these minerals in crude form and let others carry on any processing required. Thus to allow percentage depletion with respect to this added value would discriminate against those selling these minerals in crude form, since percentage depletion is not allowable to processors. [Italics supplied.]

The amendments made by this section are applicable with respect to taxable years beginning after December 31, 1948.

Senate Debate, 1949

(95 Cong. Record (Part 10); 81st Cong., 1st Sess.)

* * * * *

[12995] Mr. CHAPMAN. Mr. President, on behalf of the Senator from Pennsylvania [Mr. Martin] and myself, I ask unanimous consent that there may be included in the Record, immediately following the adoption of the percentage-depletion amendment, a brief memorandum in which are stated various reasons why *refractory clays and quartzite* should be granted percentage depletion under section 114(b) of the Internal Revenue Code. [Italics supplied.]

There being no objection, the statement was ordered to be printed in the Record, as follows:

* * * * *

H. Conference Rep. No. 1412

(81st Cong., 1st Sess. (1949) (1949–2 Cum. Bull 295))

[5]

* * * * *

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

* * * * *

[11] Amendment No. 8. The Senate amendment added a new section percentage depletion at the rate of 15 percent in the case of perlite, diatomaceous earth, tripoli, granite, marble, borax mines and deposits, sand, gravel, stone, calcium and magnesium carbonates, and all other nonmetallic clays and minerals. The conferees agreed to eliminate this amendment with the understanding that the entire matter of percentage depletion will be considered early next year after full study and hearings. The Senate recedes.

1950

[Representatives of numerous mining industries testified in extensive hearings urging (1) rejection of the Treasury's proposal to reduce the percentage depletion rates except on metals and (2) allowance of percentage depletion to additional non-metallics. To a large extent the testimony consisted of explanations of the mining, processes applied, and uses of the various minerals, the pertinent portions of which are omitted here but set forth in Part B of this Appendix. Action on the allowance of percentage depletion to additional minerals was ultimately postponed but an amendment was adopted regarding transportation from the point of extraction to the plant or mill where the ordinary treatment processes are applied. The hearings, reports, and amendment are set forth below in sequence.]

House Hearings, 1950

(Revenue Revision of 1950, Hearings before the Committee on Ways and Means, House of Representatives, 81st Cong., 2d Sess., (Vol. 1))

[7] STATEMENT OF HON. JOHN W. SNYDER, SECRETARY OF THE TREASURY

* * * * *

[17]

* * * * *

By arrangement with your committee, our staff has been working with the staff of the Joint Committee on Internal Revenue Taxation since last summer on developing legislative suggestions for eliminating loopholes. The recommendations in this area represent the product of this joint effort. Other loophopes are still under study and will be brought to the attention of your committee at some future time.

I should like to refer first to the special allowances for depletion.

SPECIAL DEPLETION ALLOWANCES

* * * * * *

[18]

* * * * * *

Specifically it is proposed that percentage depletion for oil, gas, and sulfur be reduced to 15 percent of gross income and that percentage depletion for nonmetallic minerals be reduced to 5 percent. The existing 15-percent rate for depletion allowed to the metals would be left unchanged.

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[279]

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Statement of B. A. Hardey, Shreveport, La.:

Mr. HARDEY. Mr. Chairman and gentlemen of the committee, my name is B. A. Hardey. I live in Shreveport, La., and I am an independent oil and gas producer. * * * These connections over the years have given me an insight into the many problems confronting the producer of petroleum.

* * * * * *

[282]

It is significant that the special provisions which Congress has adopted apply to oil and gas production only, and not to refining, transportation, and distribution of petroleum, since the latter operations are comparable with the usual manufacturing and distribution activities in other lines of business. The provisions have been no more than adequate to attract into this business enough activity to provide reasonable quantities of oil for an expanding economy. * * * [Italics supplied.]

* * * * * *

[310] Statement of J. RUTLEDGE HILL, Chairman, National Sand and Gravel Association, Dallas, Tex.; [314]

* * * * *

Sand and gravel compete with materials which are presently accorded the benefit of percentage depletion at the rate of 15 percent of gross income, with an over-all ceiling of 50 percent of net income. Sand and gravel should be given percentage depletion at the same rate.

* * * * *

[315]

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Mr. JENKINS. Very well. As I understand it, you speak for the sand and gravel industry all over the United States?

Mr. HILL. That is correct, sir.

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[328]

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Statement of CHARLES W. NIELSEN, treasurer, Edgar Bros. Co., Metuchen, N.J.:

Mr. NIELSEN. * * *

* * * * *

It was our intention to have this presentation made by Mr. William B. S. Winans of Aiken, S.C., president of the Kaolin Clay Producers Association. Mr. Winans is ill, unfortunately, and has asked me to make this presentation in his behalf.

I am also representing certain kaolin, or china clay, producers who are not members of the Kaolin Clay Producers Association.

The whole purpose of my appearance is to urge the retention of percentage depletion in china-clay

mining—or kaolin clay mining—the terms are synonymous—and to urge that the 15-percent figure which the present law gives china clay be retained at that level.

* * * * *

[332] Statement of RALPH L. DICKEY, president, The Kelley Island Lime & Transport Co., Cleveland, Ohio:

Mr. DICKEY. My name is Ralph L. Dickey. I am president of the Kelley Island Lime & Transport Co. of Cleveland, Ohio. I am appearing as a representative of a committee of the National Lime Association requesting a 15-percent depletion allowance for limestone when calcined or when used by the metallurgical or chemical industry. * * *

* * * * *

[335] Statement of Prof. KENNETH K. LANDES, chairman, Department of Geology, University of Michigan, Ann Arbor, Mich.:

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One year ago I prepared for the National Lime Association a survey of domestic high-grade limestone deposits. This survey has been published by that association and distributed to your committee.

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[348]

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Statement of DONALD A. CALLAHAN, Wallace, Idaho, vice president, The American Mining Congress; also representing the Idaho Mining Association and the Northwest Mining Association:

Mr. CALLAHAN. My name is Donald A. Callahan. I live at Wallace, Idaho. I am appearing here representing the American Mining Congress as its vice president. I am also representing the Idaho Mining Association and the Northwest Mining Association,

which embraces operators in Washington, Oregon, western Montana, and northern Idaho.

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[349]

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Mr. CALLAHAN. I want to address myself particularly to the subject of percentage depletion and the rates for metal mines as set forth in the amendment to the revenue laws adopted in 1932. I also wish to address myself to the subject of depletion generally as applied to mines.

As the committee is well aware, the 1932 amendment provides for depletion allowance in the following language (reading):

> The allowance for depletion shall be in the case of metal mines 15 percent * * * of the gross income from the property during the taxable year.

This amendment was adopted following a report of the staff of the Joint Committee on Internal Revenue Taxation. Although this rate and the principle of percentage depletion generally has been attacked several times since then, full hearings have been held, the Congress has seen fit to continue both the principle and the rate. * * *

* * * * * *

[351] * * * *The miner does not expect the Government to guarantee a profit to him.* He expects to pay fair taxes, but he must have at least the hope that if there are profits they will be subject only to a fair tax upon true income. The constant threat of reduction or complete elimination of depletion allowances is a deterrent to investment of risk capital and in consequence to the discovery and development of new ore bodies. [Italics supplied.]

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[352]

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I should also like to submit for the record a memorandum on depletion of mines and also a statement on mining taxation by the American Mining Congress, which I should like to submit with the request that it be inserted in the record at this point.

(The documents referred to follow:)

DEPLETION OF MINES—A STATEMENT BY THE MINING INDUSTRY

(American Mining Congress, Washington, D.C., February 1950)

* * * * *

1. *The nature of mining as distinguished from other industrial enterprises:*

To understand the problems of depletion it is necessary to have some knowledge of what is involved *in extracting minerals from the earth, processing them and delivering the metal product to the fabricators* to be fashioned into the machines and articles so essential to our modern way of life. [Italics supplied.]

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[354]

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3. *Depletion is a return to the mining industry of the capital consumed in its operations:*

The mineral in place in the ground is the principal capital of every mineral producer. As each ton is extracted, a certain portion of his capital is actually consumed. A portion of his proceeds from each ton is the return of his capital, and only a portion is income. Since the inception of the income tax, every effort has been made to tax income only, and to avoid taxing capital. Depletion is merely the method by which the return of capital is computed. The right to a

return of capital has always been recognized. This right has never been seriously questioned.

* * * * *

[355]

4. *The present system of computing depletion resulted from careful study and affords the best means for determining the annual consumption of capital:*

After years of experience with other methods of computing depletion, the Congress in 1932 included the present percentage method for metal mining, coal, and sulfur. This was upon the recommendation of the staff of the Joint Committee on Internal Revenue Taxation, which made an exhaustive study of the subject. The joint committee held extensive hearings, and the printed reports of the staff of the joint committee and of the hearings before the committee were considered by the Congress in the adoption of the percentage method and in fixing the rates. The rates so fixed were lower than the average rates actually allowed under the previous laws. Percentage depletion has subsequently been extended to certain other minerals, and the rates on these are among the rates subject to present criticism.

The following is quoted from the letter of Mr. L. H. Parker, chief of Staff to the Joint Committee on Internal Revenue Taxation, transmitting the report to the staff of that committee, dated December 17, 1929:

* * * * *

The report of the staff of the joint committee called special attention to the uncertainty and lack of uniformity under the methods of computing depletion which theretofore had been the only methods allowed. Tables were given showing the wide difference in allowances of depletion between different branches of the industry and individual taxpayers. *The inclusion*

of the percentage method has remedied this situation. [Italics supplied.]

One of the objects sought to be attained by the percentage method was the elimination of the inequality which had existed as between competing members of the mining industry. Under the methods in use prior to 1932, certain companies had been able to establish adequate depletion allowances which, by reason particularly of the geological nature of their deposits, were not available under the statute to others. The present laws tends to remove this inequality and to give all mining taxpayers some measure of protection against taxation of their capital. [Italics supplied.]

The *small-mine operator* cannot afford to spend the money necessary to establish the value of his mineral deposits and the corresponding depletion value of his unit of production. *Percentage depletion removes the necessity for such expenditures. It provides a simple, understandable method by which, from the inception of his enterprise, he may receive the reasonable allowance for depletion contemplated by the statute. It assures him fair and equal treatment with other operators.* It protects him against the taxation of the capital he has consumed in his operation. [Italics supplied.]

* * * * * *

Conclusion

* * * * *

[356] The principle of percentage depletion is *fair and equitable,* and the existing rates are not excessive. Percentage depletion permits substantial savings to both Government and taxpayer in the establishment of a basis for depletion allowances; *it protects the small taxpayer against discrimination* and against excessive taxation of his capital; it does not return

to the mining industry as a whole more than the annual consumption of its capital value; and *it constitutes the simplest and best procedure yet devised for sustaining capital investment* in an industry that is vital to the welfare and security of our country. [Italics supplied.]

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[377]

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Statement of CHARLES F. WILLIS, Phoenix, Ariz., secretary, Arizona Small Mine Operators Association:

Mr. WILLIS. The name is Charles F. Willis, of Phoenix, Ariz. I am secretary of the Arizona Small Mine Operators Association and a member of the Tax Committee of the National Minerals Advisory Council to the Department of the Interior. The Arizona Small Mine Operators Association is an organization of approximately 3,800 members who are interested in an opportunity of developing the mineral resources of the State of Arizona.

* * * * *

[379]

* * * * *

We, in Arizona, are not alone concerned with the metal-mining tax situation, but we are also interested in the proposal for the nonmetallics. We have potential resources of important nonmetallics, but their problem is not only one of applying venture capital and determining what they have. The major problem in many nonmetallics is the developing of a marketable product and creating of a market for the same. This angle often requires a greater application of skill and capital than is indicated by the value of the body of mineralized material. It has only been through the developing of a market that any value has

been created in the rock. *Yet, it is only on the value of the rock in place that depletion allowances are given,* and that is proposed to be cut. There is less and less incentive to create this new wealth. [Italics supplied.]

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[380]

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Statement of KENNETH B. RAY, counsel for Food Machinery & Chemical Corp., and also representing Phosphate Rock Industry Group:

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[381]

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At the time trona was given the right to percentage depletion the company understood that it was the fixed policy of Congress to continue the percentage-depletion allowance for trona at the 15-percent rate for the reason that the metal-mining industries had enjoyed such a rate for an extended period of time. The statements made in the congressional debates confirm this understanding. * * *

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[382]

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All of the reasons which were presented by the industry in 1947 for adding trona to the minerals entitled to percentage depletion remain true today. Among other considerations it was pointed out then that trona is comparable to metal mining and that it would be at a competitive disadvantage if forced to compete with metal mining companies that now enjoy the benefits of percentage depletion.

In 1947 the benefits of percentage depletion were also extended to phosphate deposits. This turned out

to be a particularly wise piece of legislation since the Government for many years had been endeavoring to secure widespread development of the phosphate deposits of southeastern Idaho. Following the addition of phosphates to the statute this company has expended over $10,000,000 in an electric furnace project to utilize the Idaho phosphate deposits. The economics of this development are based on *percentage depletion for the basic raw material, phosphate rock.* * * * [Italics supplied.]

* * * * *

[383] The CHAIRMAN. We thank you.

Mr. JENKINS. I ask unanimous consent that Mr. Douglas Whittlock, of Washington, D.C., be permitted to present a brief. He represents the structural clay products industry.

The CHAIRMAN. Without objection it is so ordered.

(The brief referred was not received in time for inclusion in the record.)

* * * * *

Statement of FRED O. DAVIS, vice president and treasurer, Potash Co. of America, Carlsbad, N. Mex.:

* * * * *

It is only a few years since representatives of the American potash industry appeared before both the Ways and Means Committee in the House of Representatives and the Finance Committee of the Senate. At that time potash was brought within the percentage depletion provisions of the revenue act and was granted such depletion on a permanent basis.

* * * * *

During the consideration of the Revenue Act of 1943, when percentage depletion on a permanent basis was granted to potash, a comprehensive statement with reference to the foregoing points was sub-

mitted and since that time and during the period when percentage depletion has been in effect, the following developments have occurred:

* * * * * *

[368] Mr. LYNCH. What is the price of potash f.o.b. mines?

Mr. DAVIS. The crude product is worth about $4.50 per ton of ore. The refined product, which takes 2½ tons to produce, is about $20 per ton.

* * * * *

[413] Statement of JOHN H. BISHOP, Chicago, Ill., representing Miners of Vermiculite:

* * * * *

(The prepared statement of Mr. BISHOP follows:)

[414]

* * * * *

Vermiculite is a *basic mineral which is sold in its crude or concentrated form to processors* who exfoliate it and from the processed mineral fabricate many different types of materials, all of which are sold through dealers. The income from the industry, therefore, is derived from three sources: the miners, the processors, and the dealers. [Italics supplied.]

Vermiculite ore in its concentrated form sells for approximately $10 per ton. Exfoliated vermiculite that is sold by processors brings approximately $75 per ton. * * *

[431] Statement of S. W. TUTTLE, Vice President and Secretary, International Talc Co., Inc., New York, N.Y.:

* * * * *

I would like to describe briefly the operations engaged in by my company and by other talc companies

which influenced the Congress to grant us this depletion allowance. * * *

* * * * * *

[441] Statement of E. A. GARBER, president, Harbison-Walker Refractories Corp., Pittsburgh, Pa.:

Mr. GARBER. I not only represent Harbison-Walker but over 50 refractories who produce about 90 percent of the refractory or fire material used in the United States. Next to agriculture, we probably are the second basic industry in the United States. Our products are used in every phase of industry where heat resistance is necessary.

* * * * * *

[464] Statement of JAMES W. HALEY, secretary and general counsel, National Coal Association, Washington, D.C.:

* * * * * *

[466] For the record and for the consideration of the committee, I attach to my statement five amendments of a technical nature calculated to remove from doubt some of the fields of disagreement arising between the coal industry and the Bureau of Internal Revenue. A brief description of the amendments follows.

Appendix No. 1 sets forth the language of a proposed amendment calculated to correct the tendency on the part of the Bureau of Internal Revenue to exclude from computations for purposes of percentage depletion essential elements of cost involved in transporting coal *from the place of extraction to the tipple or preparation plant.* This question is actively before the Bureau at this time and involves many coal operator taxpayers. We think the law is clearly in

our favor as it now stands, but the Bureau does not seem to think so. (Italics supplied.)

* * * * *

[468] APPENDIX No. 3

Definition of "net Income from the Property"—Amendment to Section 114(b)(4)—Internal Revenue Code.

Section 114(b)(4) is amended by adding at the end thereof a new subparagraph (C) to read as follows:

"(C) Definition of Net Income from the Property.—As used in this paragraph the term 'net income from the property' means the 'gross income *from the minerals* from the property' as defined in subparagraph (B) of this subsection, less * * * [Italics supplied.]

* * * * *

[470] Statement of Hon. HARRY P. O'NEILL, a Representative in Congress from the State of Pennsylvania:

* * * * *

MOFFAT COAL CO.,
SCRANTON 2, PA., *February 7, 1950.*

HON. HARRY P. O'NEILL,
Representative, Tenth District,
House Office Building, Washington, D.C.

DEAR MR. O'NEILL: Recently, in his tax message, the President commented on percentage depletion as applied to the mining industry and advocated the elimination of this provision of the current revenue act.

* * * * *

[471] The allowance of percentage depletion under the present law was carefully and fairly set by experience; and the percentage method affords a *simple*

and equitable means of computing the reasonable allowance for the exhaustion of the mineral deposit which has always been contemplated in the law. * * * [Italics supplied.]

* * * * * *

Statement of W. P. HAMBLEN, Houston, Tex.:

Mr. HAMBLEN. Mr. Chairman and gentlemen of the committee, I am W. P. Hamblen, of Houston, Tex. I am appearing on behalf of a number of companies engaged in the production of mineral shell deposits. I am a director and an attorney for the W. D. Haden Co., of Houston, Tex., one of the larger producers of mineral shell in the State of Texas.

* * * * *

[480] Statement of RUSSELL RAREY, president, Marble Cliff Quarry Co., Columbus, Ohio:

Mr. RAREY. I would like to have about 5 minutes, if I may. We operate a limestone open quarry near Columbus, Ohio, and in the western part of the State a limestone underground mine. * * *

[481] As a member of the executive committee and of the percentage depletion committee of the National Crushed Stone Association, I have been authorized, along with Mr. Krause, to present a statement on behalf of the National Crushed Stone Association, and the Agricultural Limestone Institute.

* * * * *

[483] We heartily favor the percentage depletion method for other mining industries, but the crushed-stone industry fails to see any essential difference between the mining of crushed stone and certain nonmetallic minerals and is convinced that the discrimination between crushed stone and other nonmetallic minerals which have long had percentage depletion should be eliminated.

[489] Statement of HORACE C. KRAUSE, president, Columbia Quarry Co., St. Louis, Mo.:

Mr. KRAUSE. My name is Horace C. Krause, President of the Columbia Quarry Co. I am chairman of the percentage depletion committee for the National Crushed Stone Association and Agricultural Limestone Institute.

* * * * * *

[491] Statement of HENRY MULRYAN, Glendale, CALIF.:

* * * * * *

At the present time I am the executive vice president and general manager of the Sierra Talc & Clay Co., which company operates 14 mines in the States of California, Nevada, New Mexico, and Montana.

* * * * * *

[492] You have heard a great deal about the percentage depletion. I would just like to make this remark, why the rates should be 15 percent. The rate for talc should be the same as that allowed metal mines. The mining, milling, and processing of talc is comparable to metal mining and in many instances requires more complex and costly operations. * * *

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H. Rep. No. 2319

(81st Cong., 2d Sess. (1950–2 Cum. Bull. 380))

[64]

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(F) PERCENTAGE DEPLETION

At your committee's hearings on this bill a number of witnesses pointed out that the depletion provisions of existing law discriminate against the producers of

certain nonmetallic minerals, including coal. Existing law permits depletion based on cost to all the mining industries, but allows percentage depletion to oil, gas, sulfur, metal mines, and certain enumerated nonmetallic minerals, if this produces a larger deduction. The rate allowed in the case of coal is 5 percent of gross income. The other enumerated nonmetallic minerals other than sulfur receive 15 percent, which is also the rate allowed to metal mines.

The testimony before your committee revealed that in a number of cases nonmetallic minerals which are not enumerated in existing law are competitive with the minerals receiving percentage depletion or have just as good a claim for such treatment as the enumerated minerals. The testimony received by your committee indicated also that the 5 percent rate allowed in the case of coal is of little practical value, and that the coal-mining industry is peculiarly in need of more favorable tax treatment because of the inroads on its potential markets by alternative sources of energy, particularly oil and gas.

Section 204 of your committee's bill adds to the list of nonmetallic minerals which may elect percentage depletion at a 15 percent rate, borax, fuller's earth, refractory and fire clay, quartzite, perlite, [65] diatomaceous earth, metallurgical and chemical grade limestone, and tripoli. Existing law allows the 15-percent rate to thenardite, but only when it is obtained from brines, or mixtures of brine. This restriction is removed by your committee's bill.

The bill increases the percentage allowed in the case of coal from 5 to 10 percent, and sets up a new group of minerals to which percentage depletion is available at the rate of 5 percent. This group consists of sand, gravel, granite, marble, stone, brick and tile clay, shale and shell.

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The rates used under the percentage depletion option are, of course, applied to the gross income from the property. In order to restrict depletion to the actual product of mineral extraction, it is stipulated in your committee's bill that the gross income to which the percentage depletion rate is to be applied shall not include income resulting from the transportation of the product beyond the property.

It is estimated that these changes in the percentage depletion allowance will reduce the revenues by about $35 million a year when fully effective.

House Debate, 1950

(96 Cong. Record (Part 7) 81st Cong., 2d Sess.)

[9282]

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Mr. CASE of South Dakota. My attention has been called to the fact that under section 204, having to do with percentage depletion, the bill proposes to add a clause to the existing law on gross income from mining in the following words: "but such term shall in no case include transportation beyond the property."

In connection with nonmetallic minerals, such as feldspar and bentonite, and other minerals of that sort, the common practice is to collect or pick up the rough ores and then transport them to a central mill. In many cases 50 percent or more of the cost of the operation is involved in getting them to the processing plant. Until these ores have been processed, they are not usable. You have only crude ores. They are not products. They are only moved rocks or clays. *The transportation to a processing mill, whether 100 yards or 20 miles, is a part of the mining. Transportation after milling or even grinding is something else. To make this clear, would the chairman say that it is not intended to deny the transportation costs where they*

are a part of the handling of the crude ore before it is processed or milled? [Italics supplied.]

Mr. DOUGHTON. The subject of depletion was one of the controversial subjects that was before our committee and was considered very carefully. What we did is the decision of the majority members of the committee.

I yield to the gentleman from Tennessee [Mr. COOPER] if he has some observation to make.

The CHAIRMAN. The time of the gentleman from North Carolina has again expired.

Mr. DOUGHTON. I yield myself four additional minutes.

Mr. COOPER. Mr. Chairman, I am sure the chairman will bear in mind, and if the gentleman from South Dakota [Mr. CASE] will refer to page 65 of the report, he will see the explanation of this provision. Briefly, it simply means this, that percentage depletion is pro-
[9283] vided for the production of the mineral but not for the transportation of it.

Mr. CASE *of South Dakota*. On page 65 the language says, "transportation of the product." If "the product" means the milled mineral, that is one thing, but if it is the crude ore, that is something else.

Mr. COOPER. Well, it is crude ore that is being talked about.

Mr. JENKINS. Mr. Chairman, will the gentleman yield to me?

Mr. DOUGHTON. I yield.

Mr. JENKINS. I would like to call attention to this proposition: Just as the gentleman from South Dakota says, there has been a great deal of complaint lately with reference to that language. I participated rather actively in this matter in the committee. We discussed this proposition, which is the mining of coal, and it was decided that in coal production there is a

lot of expense before the coal finally leaves the property on which it is mined. Sometimes it is screened, and sometimes it is washed and pulverized and made into different sizes. At that time, while we were discussing this, we intended that all that expense would be included, before taking the coal further. As an illustration, in Ohio, for instance, we have what we call strip mines. The coal is mined and taken long distances before it is disposed of. It is not treated at all. It is taken up as far as Detroit, for instance, and sold. It would not be fair to consider that transportation as a part of the depletion cost, because that is simply going too far.

Mr. CASE of South Dakota. But coal is a usable product when it is mined, generally speaking; whereas, clays are not.

Mr. JENKINS. With reference to the production of clay, in most of the countries where clay is produced the brick and clay plants are close by, contiguous to where the clay is produced, but in some places they are not. In some places the clay must be hauled long distances. If that is the case, the same applies as with reference to coal. I doubt whether the language we have does fix it definitely and closely enough. This ought to be made more specific when the bill goes to the other body. But the intention was to grant to those people who produced minerals a rather complete concession, but it was not intended to apply to that product every step they hauled it.

Mr. CASE of South Dakota. If the haulage is merely a matter of 5 or 6 or 12 or even 20 miles to a central milling plant, it seems to me it is a part of the cost of production, because the product is not usable until it leaves the mill.

Mr. JENKINS. That will be a proposition of interpretation by regulation or further clarification in the other body.

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Senate Hearings, 1950

(Revenue Revisions of 1950, Hearings before the Committee on Finance, United States Senate, 81st Cong., 2d Sess., on H.R. 8920).

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[299] Statement of M. D. HARBAUGH, vice president, Lake Superior Iron Ore Association, Cleveland, Ohio.

Mr. HARBAUGH. Mr. Chairman and members of the committee, my name is M. D. Harbaugh. I am vice president of the Lake Superior Iron Ore Association of Cleveland, representing most of the companies that mine and ship iron ore from the important Lake Superior district of Minnesota, Michigan and Wisconsin.

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Section 204(c) of the bill, regarding percentage depletion, in revising the definition of gross income from mining, would create a deterrent that certainly will adversely affect the development of low-grade ores including the taconites, which require beneficiation. Plants cannot always be established directly at the property but must be located at the nearest practical point as determined by physical conditions and other factors. The transportation is an integral part of the whole operation of mining and beneficiation. Disallowance of transportation in computing gross income for depletion, would impose a severe handicap to the industry's program for developing these low-grade deposits.

Senator MILLIKIN. How far would you carry the transportation cost?

Mr. HARBAUGH. Well, we have plants that are located several miles from the source of the ore, centralized plants which are necessarily large in which ores from numerous small pits or small workings can be treated.

Senator MILLIKIN. How do you treat the iron ore at those smaller plants?

Mr. HARBAUGH. The ore is treated in these plants by washing to remove some of the imports and by other concentration processes such as are technically known as jigging and heavy density separation.

Senator MILLIKIN. You are simply preparing the ores for the plant?

Mr. HARBAUGH. Yes, sir. *This part that is treated would not be marketable without this treatment.* [Italics supplied.]

Senator MILLIKIN. You would not run your cost down to Pittsburgh?

Mr. HARBAUGH. No. *This involves the transportation to the processing plant where we make the first marketable product.* [Italics supplied.]

Senator TAFT. And a product which can be shipped on boats?

Mr. HARBAUGH. Which can be shipped on boats and which is usable in the premises.

The CHAIRMAN. Was it not intended by the House to exclude the transportation cost of the first processing plant?

Senator TAFT. These are the words:

> * * * *but such terms shall in no case include transportation beyond the property,*

That is what the House put in.

Mr. HARBAUGH. The whole problem is, what do you mean by "the property"? If the property is the

particular place from which the crude ore is taken, then that is a very restrictive clause because the processing plant may be a few miles away or it may be a mile away.

Senator MILLIKIN. You might have four separated properties owned by the same people who have a central processing plant and this language would be ridiculous in that case.

Mr. HARBAUGH. That is right and in the future in the treatment of this taconite that will be more important than now.

The CHAIRMAN. *Mr. Stam, would you be prepared to say whether the House intended by the use of this language to exclude the cost of first processing, the first step in the processing to render marketable or merchantable the minerals?* [Italics supplied.]

[302] Mr. STAM. I think when the problem came up before the House committee they were particularly concerned with the new minerals that had come in, such as sand and gravel and some of those, and it was pointed out that if you computed the depletion allowance on the sand at the pit and then you carried it 3 or 4 miles away in a truck, that the cost would be much greater. I mean that is the way the thing originally came up, but in discussing it the House decided that they would make the amendment effective for the existing depletion allowances as well as the new depletion allowances that were brought in. *So that I think the way the amendment was worded it was intended to put a limitation on the whole allowances but it started from the idea of sand and gravel and some of those minerals that they did not want to give a bigger allowance to than the value at the time it was taken out.* [Italics supplied.]

Senator TAFT. They do not propose to include

transportation on ships down to Pittsburgh, of course?

Mr. STAM. That is right.

Senator MILLIKIN. What is the answer to the argument, if there was an argument, that it is practical to limit it to the property? We were just discussing, Mr. Stam, that sometimes there will be three or four properties all served by a central cleaning-up plant. In coal mines you have a washing problem, I assume, similar to your problem?

Mr. HARBAUGH. Very similar.

Senator MILLIKIN. *In other words, you have no salable product until you get through that first processing business which does not change the character of the product. It merely renders the product marketable.* [Italics supplied.]

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Statement of LOUIS H. HEYL, vice president and general manager, the Wyodak Chemical Co., Cleveland, Ohio:

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We are miners and processors of bentonite clay. Under section 114(b) of the Internal Revenue Code, the mining and processing of bentonite clay is granted certain exemptions in the form of percentage depletion along with several other mineral products.

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It is therefore a definitely established fact that trucking bentonite to the processing plants where it must be dried, granulated, or ground, is a vital portion of the *processing steps necessary to develop it to its "first commercially marketable product" stage;*

that is, in dried, ground, or granulated form and packed in bags. [Italics supplied.]

Senator MILLIKIN. *Your first step does not change the character of the deposit in any way?* [Italics supplied.]

Mr. HEYL. None whatever; it just reduces the moisture.

Senator MILLIKIN. That is, cleaning it up, drying it, and putting it into a certain form?

[449] Mr. HEYL. That is correct.

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[757] Statement of JAMES W. HALEY, Southern Building, Washington, D.C., secretary of The Special Tax Committee, National Coal Association, accompanied by L. H. PARKER, Chairman.

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My principle purpose in appearing before the committee today is to urge you to recommend that the Senate concur in the House action in raising the gross depletion for coal from 5 to 10 percent. I also deal with the necessity for clarifying the Internal Revenue Code [758] with respect to what constitutes gross income from the property for purposes of interpreting the depletion allowance and also with respect to corporate earnings and profits accumulated prior to March 1913.

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Statement by HENRY B. FERNALD, chairman, tax committee, American Mining Congress:

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(II) Section 204, percentage depletion: (1) We urge that you reject the Treasury recommendation

regarding percentage depletion, as the House has done after extended hearings. We believe it is unnecessary to repeat what was there presented to evidence that percentage depletion is no more than a proper allowance to the mining industry for capital exhaustion.

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(3) Section 204(c) of the bill proposes to add the words "but such term shall in no case include transportation beyond the property" at the end of the second sentence of section 114(b)(4)(B), which, for determining gross income for percentage depletion purposes, defines the term "mining" to include both extraction from the ground and also "the ordinary treatment processes normally applied." The House committee report (p. 84) states that the proposed amendment "is merely declaratory of existing law." This statement is erroneous.

Section 114(b)(4)(B) of the code was written into the law in 1943, as stated in the report of the Committee on Finance (S. Rept. 627, 78th Cong., 1st sess., p. 23):

> The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines.
>
> The law has never contained such a definition, and its absence has given rise to numerous disputes. The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions.

The first sentence of the definition in section 114(b)(4)(B) states that gross income from the property means the gross income from mining. The second sentence states that mining shall include not merely extraction of the ores but also the ordinary treatment processes normally applied. The third sentence specifies the ordinary treatment processes to be included for each of the several classifications there set forth as (i), (ii), (iii), and (iv). *The processes are stated in considerable detail, following the lines of the Treasury regulations prescribed under the 1932 act and continued for many years thereafter. Such regulations* (for example, art. 23(m)–1(g), Regulations 101) *were definite in stating that the gross income determination should be "before transportation from the place where the last of the processes listed below was applied." Transportation necessary to move the minerals to the plants where the ordinary treatment processes were performed was, like the processes themselves, to be considered as part of mining. Transportation from the place where the last of the specified processes was applied was not to be considered as part of mining; nor were any further processes beyond those specified. The processes specified gave the cut-off point between what was and what was not to be considered mining in each case.* [Italics supplied.]

We are confident that Congress, in adopting the 1943 amendment to express the intent of the prior law, intended that the definition of "gross income" written into the law should carry the same meaning and the *same cut-off point* with regard to transportation as had been set forth in the early regulations and had been followed in Bureau procedure. [Italics supplied.]

Sometimes plants for concentrating or other processes specified can be located directly on the mining

property. At other times terrain, necessary water supply, [772] or other factors may make that impossible, and a plant will be located at the nearest practical point at which the processes can be efficiently performed. This is normal mining procedure.

Lately there has been some disposition in the Bureau to raise questions in this regard which were not raised and would not have been admissible under the earlier regulations and procedures. For this reason, and because of the statement erroneously made in the House committee's report, we believe the intent of the law should be made clear by the following amendment in lieu of that proposed by section 204(c) of the bill:

(1) That the second sentence of section 114(b)(4)(B) should be amended to read as follows:

> The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground, but also (a) the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products and (b) the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plant or mill in which the ordinary treatment processes are applied thereto.

It is understood that the amendment now proposed in section 204(c) of the bill was intended primarily to apply to sand, gravel, etc., for which percentage depletion is proposed to be newly allowed by section 114(b)(4)(A)(i). If none of the existing classifications (i) to (iv) in section 114(b)(4)(B) is deemed to give the satisfactory cut-off point for these newly included minerals, the appropriate method to make clear the basis for them would be by inserting in the third sentence of section 114(b)(4)(B) a new subdivision

(v) which would specify the processes, if any, which should be considered as the "ordinary treatment processes" with respect to such minerals.

In this way the present meaning of the law will be maintained and clarified at the same time that the appropriate specifications are set forth for the newly added minerals, in harmony with the structure of the section and with its specifications for other classes of minerals.

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Senator MILLIKIN. *Will you give us some examples of the processing going on in normal operation when the ore comes out of the ground?* [Italics supplied.]

Mr. FERNALD. I will furnish that to you later if I may.

Senator KERR. With reference to the transportation, does this contemplate the reasonable ordinary cost of transportation from the mine to a mill located nearby or to what extent might that be expanded?

Mr. FERNALD. The kind of rule that we are asking for, sir, is to have it where the mill or processing plant is located at the nearest reasonable point for the efficient application of the processes, the transportation from the mine to that point.

Senator KERR. What might that involve?

Mr. FERNALD. That would depend a great deal on the question of terrain, on the location of the plant. For instance, if we take a concentrating plant, it must have adequate water supply, it must have space where tailings can be floated out from the plant. As to how closely we can place that to the mine, you can be sure that we will place it just as close to the mine as we can.

Senator KERR. Within 10 miles, 5 miles, 100 miles, or 1,000 miles?

Mr. FERNALD. Well, 10 miles, 20 miles, perhaps in very rare cases it might run up to 30 miles.

Senator KERR. Up to 30 miles?

Mr. FERNALD. Yes. There is no intention to have this run to a thousand miles. I do not think you will ever find a case where a thousand miles was the nearest place.

Senator KERR. It would not apply then to minerals obtained from some other country and shipped to a mill in the country?

Mr. FERNALD. No. *I think that would not be normal processing. It is what the normal operators do under those conditions as a normal treatment process.* But this proposed amendment would say if you move it off the edge of the property, bing, that is out. [Italics supplied.]

Senator KERR. I want to say that your position is well taken, if I understand it, and I wanted to be sure that I did understand it.

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Senator MILLIKIN. *Mr. Fernald, you were going to give us illustrations of the processing which occurs after you get the ore out of the ground, which is involved in this question of transportation. Would you mind doing that? Give us a couple of illustrations.* [Italics supplied.]

Mr. FERNALD. We have the mining property here. Perhaps it may be at the top of a hill. There is no place there to locate a mill for handling that product. It is brought down the hill.

Senator MILLIKIN. *What I am trying to develop is, what is actually done with the ore to process it?* I

think you have made that part [782] of it very clear, but what are these processing things so that the members of the committee may understand it? [Italics supplied.]

Mr. FERNALD. I see.

For instance, for our ordinary metal mines there is the concentrating of the ore by gravity or by flotation. That is, the ore as it comes out of the ground is too low grade to be profitably shipped any distance. [Italics supplied.]

Senator MILLIKIN. There is a lot of dead rock in it?

Mr. FERNALD. *It has rock in it. Of course, with some mines they will have an actual selection underground so that a lot of the waste will be left in the mine whereas the vein itself and the good ore will be hoisted to the surface. In other places, instead of trying to do any sorting underground the whole thing is sent to the mill and there, either by flotation or other concentrating processes, mechanically you eliminate a large amount of the waste rock and get the concentrates which carry the bulk of the mineral which can then be profitably shipped.* [Italics supplied.]

Senator MILLIKIN. *You are preparing your ores so that you have something to sell; that is the point, is it not?* [Italics supplied.]

Mr. FERNALD. *That is it exactly.* [Italics supplied.]

Senator MILLIKIN. *If you do not prepare them, you have nothing to sell and you do not have any income?* [Italics supplied.]

Mr. FERNALD. *That is the ordinary mining process.* [Italics supplied.]

Senator MILLIKIN. *Do you intend to carry it on to the smelting point?* [Italics supplied.]

Mr. FERNALD. *When the amendment was originally presented in 1932 that matter was considered at some length and the Treasury felt strongly it should not include smelting as an ordinary treatment process applicable to percentage depletion. So the smelting of that ore was not originally treated as includible in the percentage depletion in gross income from mining.* [Italics supplied.]

Senator MILLIKIN. Smelting is another step?

Mr. FERNALD. *Smelting is another step. Even if you have a smelter right at the mine, that still has been held by the Treasury in a ruling which has stood over since 1932 as not one of the ordinary treatment processes to be considered as mining.* [Italics supplied.]

Senator MILLIKIN. *So that all you are asking for is that transportation be included to that point where you can render your ore marketable?* [Italics supplied.]

Mr. FERNALD. *That is it.* [Italics supplied.]

Senator MILLIKIN. *That is the point?* [Italics supplied.]

Mr. FERNALD. *Yes.*

For coal, as they spoke this morning, they have this proposition of washing and classifying as part of their process. [Italics supplied.]

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[783] Statement of SAM H. WILLISTON, Los Altos, Calif., chairman of the tax committee, Mining and Metallurgical Society of America:

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[785]

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Senator CONNALLY. What do you mean by shipping mines?

Mr. WILLISTON. Those are mines producing ore and shipping to a smelter.

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S. Rep. No. 2375

(81st Cong., 2d Sess. (1950–2 Cum. Bull. 483))

[52]

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XI. OTHER ADJUSTMENTS IN THE TAX LAW

(A) MEASURES CONTAINED IN THE HOUSE BILL

(1) *Percentage Depletion*

Section 204 of the House bill would amend section 114(b) of the code dealing with percentage depletion. The percentage allowed coal would be increased from 5 to 10; a number of items would be added to the list of nonmetallic minerals receiving the 15-percent rate; and a new group of nonmetallic minerals would receive percentage depletion at the rate of 5 percent. The House bill also includes an amendment intended to redefine the gross income upon which the percentage depletion rate is applied.

Section 208 of your committee's bill eliminates the increase in the rate on coal and the allowance of percentage depletion for the additional nonmetallic minerals enumerated in the House bill. An estimated revenue loss of $35,000,000 annually is involved, which is difficult to reconcile with the need for revenue at the present time. Moreover, your committee is not convinced that all of the items to which percentage depletion would be extended have a valid claim to such treatment. In those cases where a valid claim for some additional depletion allowance exists, it is not evident that the percentage rates used in the House bill are necessarily the appropriate ones. Thus, it appears desirable to postpone action on these pro-

posals until your committee can carry out a more careful analysis of the problems involved.

Under the House bill the "gross income from the property" upon which percentage depletion is applied does not include any amount which reflects transportation beyond "the property." While this rule may be equitable when the *first processing* occurs on the property, it discriminates against the case where the *first processing* must be done elsewhere. Accordingly your committee has amended this provision so as to make it conform with what your committee believes is the intent of existing law. *The code section here involved was added in the 1943 Revenue Act so that the law would clearly have the same meaning as that intended by the depletion provisions in the 1932 act and contemporary Treasury regulations interpretative thereof.* Those regulations specified that the gross income computation for depletion [53] purposes was to be "before transportation from the place where the last of the processes listed below was applied." Terrain, water supply, or other factors, sometimes permit the application of ordinary treatment processes directly on the mining property. At other times the plants to apply such processes to obtain the commercially marketable mineral products are normally located some distance from the mouth or opening of the mine, but are at the nearest practicable point at which such processes can be efficiently performed. The transportation to these plants and the ordinary treatment processes applied are included as a part of mining in determining gross income for percentage depletion purposes. [Italics supplied.]

This rule, intended to be applied in accordance with normal standards, clearly would not extend to transportation to distant points far beyond the locations where mine operators would normally locate

such plants. But the rule would be applicable when the location of the plant or mill is at a point not substantially more distant from the point of extraction than is reasonably necessary for efficient and economical operation.

In order to remedy another problem pointed out to your committee at its hearings, the bill defines "ordinary treatment processes" in the case of bentonite to include crushing, drying, pulverizing or granulating, and loading for shipment.

The amendments made by this section of your committee's bill will be applicable to taxable years beginning after December 31, 1949.

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H. Conference Rep. No. 3124

(81st Cong., 2d Sess. (1950-2 Cum. Bull. 580))

[7]

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Amendment numbered 65:

That the House recede from its disagreement to the amendment of the Senate numbered 65, and agree to the same with an amendment, as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

Sec. 207. PERCENTAGE DEPLETION.

(a) Transportation From Mine.—The second sentence of section 114(b)(4)(B) (relating to the definition of gross income from property) is hereby amended to read as follows: "The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores

or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills."

[8] *(b) Effective Date.—The amendment made by subsection (a) shall be applicable with respect to taxable years beginning after December 31, 1959.*

And the Senate agree to the same.

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[21] STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE:

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Amendment No. 65: The House bill (1) increased the percentage depletion allowance for coal, (2) allowed percentage depletion for the first time for certain minerals, and (3) provided that the gross income from mining upon which percentage depletion allowances are based should in no case include transportation beyond the property. The Senate amendment (1) strikes out these provisions of the House bill, (2) provides, effective with respect to taxable years beginning after December 31, 1949, that gross income from mining shall include transportation from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto, and (3) amends, effective with respect to taxable years beginning after December 31, 1946, the definition of "ordinary treatment processes" with respect to bentonite.

The House recedes with an amendment which eliminates those provisions of the Senate amendment relating to bentonite and limits the transportation permitted by the Senate amendment to be included as gross income from mining to so much of such transportation as does not exceed 50 miles unless the Secretary finds conditions to be such that the mineral must be transported to a greater distance to the plant or mill in which the ordinary treatment processes are applied.

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House Debate, 1950

(96 Cong. Record (Part 11))

81st Cong., 2d Sess.

[15590] Mr. JENKINS. * * *

* * * * *

Let us go a little further. Many of you were tremendously interested in depletion, allowances on gas, oil, clay, coal, and many other minerals that come from the earth. For years there has been a depletion allowance granted on these minerals. In the tax bill passed by the House we increased these depletion allowances and added a number of minerals to the list, including chemical limestone and a number of clays. It was thought proper at that time to do so. Now, the Senate in its desire to raise revenues cannot raise revenue by reducing revenue. So practically all of [15591] those depletion allowances the House made have been lost. They have been lost so that those who would have received them may count these losses as a contribution to meet the expenses of the war in Korea.

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Mr. CASE of South Dakota. I have read the conference report, particularly the depletion section, and

I want to commend the gentleman from Ohio and those who assisted for working out the provision which permits up to 50 miles transportation in computing depletion allowances where that transportation is necessary to get the materials to the processing plant. In processing clays, it is impossible to have a plant set on every quarter section where the material is located. The gentleman will recall that when the tax bill was up for consideration in the House the latter part of June he and I had a colloquy on this matter. The gentleman expressed his interest in the matter and suggested it could be worked out in conference. I appreciate what the gentleman from Ohio and others have done to work out a satisfactory provision.

Mr. JENKINS. I thank the gentleman for his contribution. To explain what it means a little more definitely to those of you who live in clay-producing and coal-producing sections and oil-producing sections where depletion allowances are permitted. If a brick plant, for instance, has to get its clay say 2 or 3 miles from the factory where it is processed the cost of manufacturing the brick should include the cost of transporting that clay. If you are not allowed a depletion allowance for the cost of transporting the principal material used in your manufacturing process then your depletion allowance does not cover the real cost of production. However, in the preparation of the new bill language has been inserted that provides a depletion allowance for transportation. The distance is limited to 50 miles, and there are some other conditions that must be met that I cannot now explain. This transportation allowance will apply more particularly in the western part of the country where they are required

to haul materials a longer distance to the place where processing is effected.

Mr. REED of New York. Many of these products upon which depletion is being asked have no value until they reach the processing plant; is that correct?

Mr. JENKINS. Yes; without the depletion allowance we would not have much of the materials and minerals that are now processed into valuable articles of commerce.

* * * * *

Revenue Act of 1950

(c. 994, 64 Stat. 906, 931 (approved September 23, 1950))

SEC. 207. PERCENTAGE DEPLETION.

(a) *Transportation From Mine.*—The second sentence of section 114(b)(4)(B) (relating to the definition of gross income from property) is hereby amended to read as follows: "The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills."

(b) *Effective Date.*—The amendment made by subsection (a) shall be applicable with respect to taxable years beginning after December 31, 1949.

[After hearings which were largely a repetition of those held the prior year, percentage depletion was allowed for various additional minerals. Again, to a large extent, the testimony at the hearings related to the mining, processes applied, and uses of the minerals. The pertinent portions thereof are omitted here but included in Part B of this Appendix. Other portions of the hearings and debates, as well as the legislative reports and the statute as enacted, are set forth below in sequence.]

House Hearings, 1951

(Revenue Revision of 1951, Hearings Before the Committee on Ways and Means, House of Representatives, 82d Cong., 1st Sess. (Part 3))

[1537] Statements of J. Rutledge Hill, Dallas, Tex., Chairman of the Committee on Taxation, National Sand and Gravel Association, and Charles E. Brady, Salisbury, N.C., Vice Chairman of the Committee on Taxation, National Sand and Gravel Association:

* * * * *

Mr. HILL. In behalf of the commercial sand and gravel industry of the United States, I ask your committee to recommend to the House that sand and gravel be added to the list of nonmetallic minerals entitled to percentage depletion.

* * * * *

[1539] Our industry believes that percentage depletion for the mining industry is sound public policy. We also believe that sand and gravel should be brought under that policy, for the reasons which I have stated. It seems to us an unreasonable discrimination against our industry to continue to be denied

the benefit of a taxation policy already extended to other members of the nonmetallic minerals family.

* * * * *

[1540] Mr. BRADY. Chairman Doughton and members of the Ways and Means Committee, I am Charles E. Brady, sales manager for four gravel and sand plants in North Carolina.

Mr. Hill, who preceded me, has covered the essential points which stress our urgent need for an adequate percentage depletion allowance. In North Carolina we have experienced a greatly accelerated depletion of our known gravel and sand deposits within the last year and a half.

* * * * *

[1541] Mr. JENKINS. There are no really large sand and gravel companies, are there, such as you run into in the big steel companies?

Mr. HILL. That is correct. They are usually very small operators as you would describe a business enterprise.

* * * * *

[1542] Statement of JAMES W. HALEY, Secretary, Special Tax Committee, National Coal Association, Washington, D.C.:

* * * * *

[1544] We are here today to urge the Congress to reduce this inequitable treatment between coal and its competitors by increasing the depletion rate for coal to 10 percent.

* * * * *

[1553] Statement of RALPH L. DICKEY, President, The Kelley Island Lime & Transport Co., Cleveland, Ohio:

* * * * *

[1553–1554] I am a representative of a committee of the National Lime Association and am requesting that a percentage depletion allowance be provided for metallurgical and chemical grade limestone at a rate of 15 percent. * * * *

* * * * *

[1571] Statement of Donald A. Callahan, Representing the American Mining Congress, Washington, D.C.:

* * * * *

I am addressing myself particularly to the subject of percentage depletion and the rates for metal mines as set forth in the amendment to the revenue laws adopted in 1932. I also wish to address myself to the subject of depletion generally as applied to mines.

* * * * *

As the committee is well aware, the 1932 amendment provides for depletion allowance in the following language:

> The allowance for depletion shall be in the case of metal mines 15 percent * * * of the gross income from the property during the taxable year.

Perhaps it would be well at the outset to review briefly the experience which formed the basis for the 1932 amendment. Depletion allowances in natural resource industries have been recognized since the adoption of the income-tax amendment in 1913. Such allowances were based upon the fact that earnings from such industries could only be obtained through the using up of the resources themselves and that such consumption resulted ultimately in the complete exhaustion of the resources which constituted the assets of the taxpayer. It had been early recognized that depletion should not be based solely on cost or March

1, 1913, value, but that the value of discovered minerals should in itself be a basis for allowable depletion. It was correct in theory to give this recognition to the exhaustion of the capital asset. It was essential in practice that this should be done if we were to have a continuing and expanding mineral industry and to deal fairly with it. The difficulty was as to the technicalities introduced and the methods employed.

Prior to 1926 when the principle of percentage depletion was first applied to the oil and gas industry, and to 1932 when it was first applied to metal mining, the method employed in determining a proper allowance for depletion was this: First, an estimate was arrived at of the number of recoverable units in the property. Then through a very involved analytic process the present worth of each unit as of the date of valuation was calculated, and this multiplied by the number of units extracted each year was the basis for the depletion allowance. This process involved the use of many unknown and unknow-[1572] able factors, and resulted in great uncertainties and inequalities. It was an involved, difficult, and costly method of determining depletion allowance.

The oil and gas industry was granted a depletion allowance based upon a percentage of its gross income in the Revenue Act of 1926. At the same time metal miners sought to secure similar treatment. The Congress decided that it had not sufficient evidence upon which to establish an equitable rate and later the staff of the Joint Committee on Internal Revenue Taxation prepared an exhaustive report. *This report, popularly known as the Parker Report, is the basis upon which the rate of 15 percent for metal mines was finally established in the Revenue Act of 1932.* The report showed that the average allowance for a con-

siderable period of time in the case of metal mines had been approximately 17 percent under the old methods employed. The metal mining industry accepted a rate of 15 percent as equitable at that time and this rate has prevailed since. [Italics supplied.]

* * * * *

The old methods in use before percentage depletion was written into the law involved complicated processes for determining the present value of the units contained in the ground. I do not need to tell you how difficult and untrustworthy such processes were. I do not need to tell you what engineering and scientific staffs were required by the Bureau of Internal Revenue to check returns which were furnished by [1573] engineering, scientific and accounting staffs which the mining companies found it necessary to employ in order to make a satisfactory return. It was largely because of these difficulties that the *simple method* of determining the amount of depletion each year through a percentage based *upon the gross values of the ore produced* was agreed upon. *Through this method the small producer is on a par with the larger operator who could provide the necessary technical staff.* The Bureau of Internal Revenue was provided with a simple method of determining the amount to be allowed. *Discriminations as between individual producers of the same metal were eliminated.* Percentage depletion has added materially to the revenue derived by the Government and has decreased the cost of its collection. [Italics supplied.]

* * * * *

What we of the mining industry ask is that there be no curtailment of the *modest* depletion allowance now effective, but rather an increase in such allow-

ance and a liberalization of the laws applicable to mining operations * * *. [Italics supplied.]

* * * * * *

[1574] I also ask, gentlemen, to be permitted to file a booklet on Mining Taxation, prepared by the American Mining Congress in February 1950, and a statement on "Depletion of Mines," recently prepared by the same organization.

The CHAIRMAN. Without objection, that will be done. We thank you for your appearance and the information you have given the committee.

(The documents referred to are as follows:)

MINING TAXATION—CHANGES IN FEDERAL TAX LAWS NEEDED TO ENCOURAGE MINING ENTERPRISE

* * * * * *

[1577] IV. ADEQUATE ALLOWANCES FOR PERCENTAGE DEPLETION

The percentages used in computing percentage depletion, both with respect to gross income and with respect to net income, should be increased.

Percentage depletion was first granted to mines in 1932 as *a simple and equitable means of measuring the exhaustion of the capital value of the mineral deposit* during the life of the mine—without the technicalities of the unit-depletion method based on cost, discovery value, etc. The allowance for depletion in the case of metal and some nonmetallic mines is computed at 15 percent of the gross income from the property, but not more than 50 percent of the net income from the property. The 15 percent rate was somewhat less than the average depletion which had previously been allowed for metal mines, as deter-

mined by careful studies by Government engineers. [Italics supplied.]

* * * * * *

[1579] DEPLETION OF MINES

(A statement by the mining industry.)

* * * * *

[1581] 3. *The depletion allowance is merely a means for returning to the owner or producer of minerals the capital consumed in the enterprise.*

* * * * *

4. *Percentage depletion resulted from a careful study by Congress. It affords the simplest and best method for determining the annual consumption of capital in the mineral-extractive industries.*

After years of difficult experience with other methods of computing depletion allowances for mines, Congress in 1932 adopted the percentage method for metal mines, coal and sulfur deposits. Previously, in 1926, the percentage basis for depletion had been adopted for oil and gas, and reports by the staff of the Joint Committee on Internal Revenue Taxation and by the Treasury Department showed that it had "functioned satisfactorily both from the economical and administrative viewpoints and without loss to the Government."

The joint committee held extensive hearings, and its technical staff made extensive studies on the subject of mine-depletion allowances. Printed reports of the hearings and of the staff studies and recommendations were fully considered by Congress in adopting the percentage method and the rates. * * *

* * * * *

[1582]

CONCLUSION

* * * * *

Percentage depletion, *by its simplicity and obvious fairness,* permits substantial savings in administration to both Government and taxpayer; it *avoids discrimination* against smaller taxpayers; it is a protection against the excessive taxation of capital; it is *the simplest and best procedure* yet devised for sustaining capital investment in an industry that is vital to our national welfare and security. [Italics supplied.]

* * * * *

[1583] Statement of WESLEY E. DISNEY, Representing Eastern Magnesia Talc Co., Burlington, Vt.

* * * * *

(Mr. Disney later filed the following statement:)

Statement of WESLEY E. DISNEY in support of percentage depletion allowance for talc producers.

* * * * *

There is a striking similarity in the problems of finding, developing, producing, and processing of talc and that of metallic minerals with the additional difficulty that talc quite often occurs in nature in much smaller deposits than the metallics. All the elements of risk involved in metal mining are present in talc mining, but this is coupled with the fact that the talc industry is composed of small business and because of the variety of grades and types of talc, each producer must process to the exacting customer requirements and must sell directly to the consumer.

* * * * *

H. Rep. No. 586

(82d Cong., 1st Sess. (1951) (1951-2 Cum. Bull. 357))

[29]

I. Percentage Depletion

Under existing law depletion based on cost is available to all mining industries and in addition percentage depletion is available to oil, gas, sulfur, metal mines, and certain nonmetallic minerals. The allowable rate of percentage depletion is 5 percent in the case of coal, and 15 percent in the case of the other nonmetallic minerals except sulfur which is allowed 23 percent.

The testimony received by this committee both in connection with this bill and the bill which became the Revenue Act of 1950 revealed that in a number of cases nonmetallic minerals which are not in the enumerated group under existing law *are competitive with those receiving percentage depletion, or have just as good a claim for such* [30] *treatment as the enumerated minerals.* The testimony also indicated that the 5-percent rate allowed coal is of little practical value, and that the coal mining industry is peculiarly in need of more favorable tax treatment because of the inroads which alternative sources of energy, particularly oil and gas, have made on the potential markets of coal. [Italics supplied.]

Section 304 of this bill adds to the list of nonmetallic minerals to which percentage depletion is available at a 15-percent rate, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, perlite, diatomaceous earth, and metallurgical and chemical grade limestones. The amendment also makes it clear that the 15-percent rate applies to thenardite, whether or not obtained from brines, or mixtures of brine.

The bill increases the percentage allowed in the case of coal from 5 to 10 percent, and sets up a new group

of minerals to which percentage depletion is available at the rate of 5 percent. This group consists of sand, gravel, stone, including pumice, scoria, and slate, brick and tile clay, shale, oyster shell, clam shell, granite, marble and asbestos.

Most of these changes would have been made under the House version of the bill which became the Revenue Act of 1950 but they were eliminated from the final legislation largely because of the revenue loss involved. It is apparent, however, that the need for equalization is substantially greater now because of the additional taxes imposed under the legislation of 1950 and under this bill. Therefore, the committee believes that the proposed extension of the percentage depletion system is necessary in spite of the revenue loss involved. The latter is estimated to be about $67 million in a full year's operation. [Italics supplied.]

The amendments made by this section of the bill apply to taxable years beginning after December 31, 1950.

* * * * *

[67] DETAILED DISCUSSION OF THE TECHNICAL PROVISIONS OF THE BILL

* * * * *

[114] SEC. 304. PERCENTAGE DEPLETION.

This section of the bill grants a percentage-depletion allowance at the rate of 5 percent in the case of deposits of asbestos, sand, gravel, granite, marble, stone (including pumice, scoria, and slate), brick clay, tile clay, shale, clamshell, and oystershell. Percentage-depletion allowance is also provided in the case of deposits of tripoli, borax, fuller's earth, refractory and fire clay, quartzite, perlite, diatomaceous earth, metallurgical-grade limestone, and chemical-grade limestone, at the rate of 15 percent. The 5-percent

rate of percentage depletion now allowed for coal has been increased to 10 percent. The allowances are of the stated percentages of the gross income from the property but not in excess of 50 percent of the net income (computed without allowance for depletion) from the property.

Subsection (b) of this section makes a technical amendment to paragraph (2) of section 114(b) of the code in order to eliminate the necessity of listing by name those mines for which depletion based on discovery value is denied by reason of the allowance of percentage depletion.

Your committee has made technical amendments to section 114(b)(4)(A) which do not alter its substance. A change has also been made in the parenthetical clause stating the source from which thenardite is derived. Under the present wording of the section, percentage depletion is allowed for thenardite produced from brines or mixtures of brine. To remove any ambiguity your committee has changed the wording of this section so that thenardite, including thenardite from brines or mixtures of brine, is permitted the percentage depletion allowance.

The amendments made by this section of the bill shall apply only with respect to taxable years beginning after December 31, 1950.

* * * * *

House Debate, 1951

(97 Cong. Record (Part 5), 82d Cong., 1st Sess.)

[6889]

* * * * *

REVENUE ACT OF 1951

Mr. DOUGHTON. * * *

* * * * *

[6890] This is the setting, then, in which we ask favorable consideration of the pending bill, which includes the following major provisions:

* * * * *

[6891]

Fourth. Percentage depletion: Another relief provision is one granting percentage depletion to certain new minerals, and increasing percentage depletion in the case of coal from 5 percent to 10 percent. The following new group of minerals is allowed percentage depletion at the rate of 5 percent: Sand, gravel, stone—including pumice, scoria, slate—brick and tile clay, shale, oyster shell, clam shell, granite, marble, and asbestos.

The following minerals are added to the list of minerals receiving a 15-percent depletion allowance: Borax, fuller's earth, tripoli, refractory and fire clay, quartzite, perlite, diatomaceous earth, and metallurgical and chemical grade limestone.

Many of these minerals compete with minerals now being granted a depletion allowance, and *the committee thought it desirable to place such minerals on a competitive basis as far as the depletion allowance is concerned.* [Italics supplied.]

* * * * *

S. Rep. No. 781

(82d Cong., 1st Sess. (1951) (to accompany H.R. 4473) (1951-2 Cum. Bull. 458))

[37] 6. *Percentage depletion.*

Under existing law depletion based on cost is available to all mining industries and in addition percentage depletion is available to oil, gas, sulfur, metal mines, and certain nonmetallic minerals. The allowable rate of percentage depletion is 5 percent in the case of coal, and 15 percent in the case of the other

nonmetallic minerals except sulfur which is allowed 23 percent.

The testimony received by this committee both in connection with this bill and the bill which became the Revenue Act of 1950 revealed that in a number of cases nonmetallic minerals which are not in the enumerated group under existing law *are competitive with those receiving percentage depletion, or have just as good a claim for such treatment as the enumerated minerals.* The testimony also indicated that the 5-percent rate allowed coal is of little practical value, and that the coal mining industry is peculiarly in need of more favorable tax treatment because of the inroads which alternative sources of energy, particularly oil and gas, have made on the potential markets of coal. [Italics supplied.]

Both section 319 of your committee's bill and section 304 of the House bill set up a new group of minerals to which percentage depletion is available at the rate of 5 percent. Both bills extend this rate to sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, and marble. In addition, your committee has added to this category entitled to the 5-percent rate sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, potassium chloride, and bromine. In the allowance of percentage depletion for these items, your committee does not intend to reduce allowances now granted. For example, potash is allowed percentage depletion at 15 percent under present law, and your committee does not intend to reduce this allowance with respect to potash or any of its salt derivatives which are presently receiving percentage depletion at 15 percent. The bill also makes a technical change in this portion of the House provision by including slate as a separate item rather

than including it as a type of stone as in the House bill.

The House bill also included asbestos at the new 5-percent rate. Because of the importance of this product and the smallness of its supply in this country, your committee has allowed asbestos a 10-percent rate. Both bills increase coal from its present 5-percent rate to 10 percent.

[38] The House bill added to the list of nonmetallic minerals, to which percentage depletion is available at a 15-percent rate, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, perlite, diatomaceous earth, and metallurgical and chemical grade limestones. Your committee's bill, on the other hand, provides that these items added by the House are to receive percentage depletion at the same 10-percent rate accorded coal and asbestos. In addition to these items, your committee has added a 10-percent rate for wollastonite, which is important as an insulating and fireproofing material and *thus competitive* with other items presently accorded similar treatment, and the magnesium compounds magnesite, dolomite, and brucite. [Italics supplied.]

Your committee's bill adds to the nonmetallic minerals presently receiving 15-percent depletion, aplite. This material, which is found in only small quantities in this country, is closely related to feldspar, which already receives 15-percent depletion.

Your committee has also made two technical revisions in the 15-percent depletion section of the House bill. The latter includes at the 15-percent rate "thenardite (including thenardite from brines or mixtures of brine.)" Your committee has eliminated the parenthetical limitation as unnecessary and because it might give rise to doubt as to certain other of the enumerated products. For example potash, trona,

and borax are also frequently recovered from brines or mixtures of brine. The phrase "mines and other natural deposits" is clearly broad enough to include brines as well as all other natural sources. The particular type of source is immaterial.

The names of all the various enumerated minerals are of course intended to have their commonly understood commercial meaning. For example, the term "thenardite" applies to sodium sulphate, also known as salt cake; the term "trona" to sodium carbonate and sodium bicarbonate, also known as soda ash; and the term "borax" to boron minerals generally.

Your committee has also amended the House provision which reads "ball and sagger clay" to read "ball clay, sagger clay" in order to remove the implication of the House bill that these are not separate types of clay.

Many of the above changes were provided in the House version of the bill which became the Revenue Act of 1950 but they were eliminated by your committee and from the final legislation largely because of the revenue loss involved. It is apparent, however, that the need for equalization is substantially greater now because of the additional taxes imposed under the legislation of 1950 and under this bill. Therefore, the committee believes that the proposed extension of the percentage depletion system is necessary in spite of the revenue loss involved. The latter is estimated to be about $76 million in a full year's operation. [Italics supplied.]

The amendments made by this section of the bill apply to taxable years beginning after December 31, 1950.

* * * * *

S. Rep. No. 781 (Part 2)

(82d Cong., 1st Sess. (1951) (1951-2 Cum. Bull. 545))

[1] DETAILED DISCUSSION OF THE TECHNICAL PROVISIONS OF THE BILL

* * * * *

[37] SEC. 319. PERCENTAGE DEPLETION.

This section corresponds to section 304 of the bill as passed by the House. The House bill granted a percentage depletion allowance at the rate of 5 percent in the case of deposits of asbestos, sand, gravel, stone (including pumice, scoria, and slate), brick clay, tile clay, shale, oyster shell, clam shell, granite, and marble. Your committee has granted percentage depletion in the case of asbestos at the rate of 10 percent and has added to the above list sodium chloride and, if produced from brine wells, calcium chloride, magnesium chloride, potassium chloride, and bromine. Your committee has removed slate from the parenthetical clause following stone and has included it as a separate item in this 5-percent category. The House bill increased the 5-percent rate of percentage depletion now allowed for coal to 10 percent. Your committee has followed this treatment in the case of coal and has included in this new 10-percent category those minerals which the House bill would have allowed percentage depletion at a rate of 15 percent. These minerals are borax, fuller's earth, tripoli, refractory and fire clay, quartzite, perlite, diatomaceous earth, metallurgical grade limestone, and chemical grade limestone. Your committee has also added wollastonite, magnesite, dolomite, and brucite to this 10-percent list, and has added aplite to the listed materials now allowed percentage depletion at the 15-percent rate.

Subsection (b) of this section makes a technical amendment to paragraph (2) of section 114(b) of the code in order to eliminate the necessity of listing by name those mines for which depletion based on discovery value is denied by reason of the allowance of percentage depletion.

Your committee has made technical amendments to section 114(b)(4)(A) which do not alter its substance. The House bill changed the parenthetical clause, stating that thenardiate produced from brines or mixtures of brine would be allowed percentage depletion, to state that thenardite, including thenardite from brines or mixtures of brine, would be permitted such allowance. Your committee believes that the same effect can be achieved by striking the parenthetical clause.

The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1950.

* * * * *

H. Conference Rep. No. 1213

(82d Cong., 1st Sess. (1951)(1951-2 Cum. Bull. 622))

[17] Amendment numbered 53: That the House recede from its disagreement to the amendment of the Senate numbered 53, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

"(i) *in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine, 5 per centum,*

"(ii) *in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, cal-*

cium carbonates, and magnesium carbonates, 10 per centum,

"(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite thenardite, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone, and potash, 15 per centum, and

And the Senate agree to the same.

* * * * *

[76] Amendment No. 53: The House bill granted a percentage depletion allowance at the rate of 5 percent in the case of deposits of asbestos, sand, gravel, stone (including pumice, scoria, and slate), brick clay, tile clay, shale, oyster shell, clam shell, granite, and marble. The Senate amendment granted percentage depletion in the case of asbestos at the rate of 10 percent and added to the above list sodium chloride and, if produced from brine wells, calcium chloride, magnesium chloride, potassium chloride, and bromine. The Senate amendment removed slate from the parenthetical clause following stone and included it as a separate item in this 5-percent category. The House bill increased the 5-percent rate of percentage depletion now allowed for coal to 10 percent. The Senate amendment followed this treatment in the case of coal and included in this new 10-percent category those minerals which the House bill would have allowed percentage depletion at a rate of 15 percent. These minerals are borax, fuller's earth, tripoli, refractory and fire clay, quartzite, perlite, diatomaceous earth, metallurgical grade limestone, and chemical

grade limestone. The Senate amendment also added wollastonite, magnesite, dolomite, brucite, and calcium and magnesium carbonates, to this 10-percent list, and added aplite and garnet to the list now allowed percentage depletion at the 15-percent rate.

The bill, as passed by both the House and the Senate, made technical amendments to section 114 (b)(4)(A) which do not alter its substance. The House bill changed the parenthetical clause, stating that thenardite produced from brines or mixtures of brine would be allowed percentage depletion, to state that thenardite, including thenardite from brines or mixtures of brine, would be permitted such allowance. The Senate amendment achieved the same effect by striking the parenthetical clause.

The amendments made by both Houses are applicable only with respect to taxable years beginning after December 31, 1950.

The House recedes with an amendment which restores borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, and chemical grade limestone to the 15-percent category in which they appeared in the House bill and which removes potassium chloride from the list of minerals to which [77] the Senate bill granted the percentage depletion allowance at the 5-percent rate. Potassium chloride is entitled, under existing law, to percentage depletion allowance at 15 percent. Under the conference agreement calcium carbonates are granted an allowance of 10 percent, while marble, which is a calcium carbonate, receives 5 percent. It is intended, in any case where a mineral is specifically provided for at a stated rate of percentage allowance, that the specific provision will govern over the allowance provided (whether higher or lower) for a more general classification.

It is the intention, in including stone in the 5 percent percentage depletion category, to limit such term to its commonly understood meaning. Thus, depletion would be allowed in the case of common stone which is crushed for use in building roads but would not be allowed in the case of precious stones such as diamonds.

* * * * *

Revenue Act of 1951

(c. 521, 65 Stat. 452, 497 (approved October 20, 1951))

SEC. 319. PERCENTAGE DEPLETION.

(a) *Allowance of Percentage Depletion.*—So much of paragraph (4) of section 114(b) as precedes the last sentence of subparagraph (A) is hereby amended to read as follows:

"(4) *Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.*—

(A) *In general.*—The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

"(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine, 5 per centum,

"(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum,

"(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet, feldspar, mica, talc (including phyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite,

thenardite, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone, and potash, 15 per centum, and

"(iv) in the case of sulfur, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property."

(b) *Technical Amendment.*—So much of paragraph (2) of section 114(b) as precedes "discovered by the taxpayer after February 28, 1913" is hereby amended to read as follows:

"(2) *Discovery value in the case of mines.*—In the case of mines (except mines in respect of which percentage depletion is allowable under paragraph (4) of this subsection)".

(c) *Effective Date.*—The amendments made by this section shall be applicable only with respect to taxable years beginning after December 31, 1950.

1953–1954

[In Section 613(c) of the Internal Revenue Code of 1954 the definition of "gross income from the property" was continued in its same form except for minor additions to the definition of "ordinary treatment processes." Adoption of the Code was preceded by hearings at which some statements were submitted on percentage depletion. The pertinent portions of the legislative reports and hearings are set forth below in sequence.]

(General Revenue Revision, Hearings before the Committee on Ways and Means, House of Representatives, 83d Cong., 1st Sess. (Part 3))

[1982]

* * * * * *

Statement of HENRY B. FERNALD, Montclair, N.J., Chairman, Tax Committee, American Mining Congress:

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[1986]

* * * * * *

THREE-YEAR EXEMPTION FOR NEW MINES

* * * * * *

The CHAIRMAN. I would like to ask you another question, Mr. Fernald.

Do you think, in defining minerals, we should be careful to separate the value added by manufacturing?

[1987] Mr. FERNALD. I think as we speak of manufacturing, as you and I are dealing with the use of that term, I can say, "Yes; I think we should." However there are very many processings of these minerals which I would never think of as being manufacturing, and I do not think you would, and yet which many do argue should be excluded because it is a manufacturing process.

The ordinary treatment processes which are normally applied to bring your minerals into a marketable condition I do not think should be talked of as *manufacturing* costs. [Italics supplied.]

The CHAIRMAN. I agree with you on that, because, for instance, they have mines up in my State where

the product cannot be sold until it is ground fine enough to go into the market.

* * * * * *

[2033]

* * * * * *

Statement of HENRY MULRYAN, president, Sierra Tale & Clay Co., South Pasadena, Calif.:

* * * * * *

[2035] Although no blending, concentration, or other beneficiation is required, with the exception of a single operation in Vermont, tale must be ground to be salable. * * * Substantially all tale sales are made by the mine operator directly to the ultimate consumer. There is practically no commercial use for the raw ore until it has been finely ground. * * *

* * * * * *

[2036] The CHAIRMAN. Pardon me. Not only in the fact of the statute itself, but without grinding you could not sell the tale in your State?

Mr. MULRYAN. That is correct. Practically all of it has to be fine ground to be marketable.

* * * * * *

[2037] We therefore ask that section 114(b)(4)(B)(iv) be amended to add "tale" to the list of minerals now contained in that subsection. We think this addition would make clear that Congress intended in section 114 that in the case of tale which is not customarily sold in its crude form, the term "ordinary treatment processes" includes crushing and all grinding *necessary to bring the product to a commercially marketable state. We think that is precisely what the law says today and what Congress intended,* because when the law was amended in 1947 to include tale on a permanent basis, Congress acted in the light of testimony by the industry which showed clearly

that talc is not customarily sold in its crude form, and that it must undergo fine grinding to get it into a marketable state. [Italics supplied.]

* * * * *

[2070] Statement of RUSSELL P. HEUER, representing the Refractories Institute:

Mr. HEUR. My name is Russell P. Heuer. I am vice president of General Refractories Co., Philadelphia, Pa. I represent the Refractories Institute, a national association of 87 refractory manufacturers, and this statement is made in behalf of its members and the entire refractories industry. I wish to cite the benefits to the national economy which have been derived from the granting of the allowance for percentage depletion to refractory and fire clays and quartzite by the 1951 Revenue Act and to urge the retention of this provision in its present form.

The specific Internal Revenue Code provision to which I refer is section 114(b)4(A), which was amended by Congress in Public Law 183, 82d Congress, 1st session, by the addition of "refractory and fire clays, quartzite" to the minerals subject to percentage depletion.

* * * * *

MINERALS USED IN THE MANUFACTURE OF REFRACTORIES

Refractory products are *manufactured* from carefully selected minerals, the chief minerals being refractory and fire clay and quartzite. The raw minerals are crushed, ground, and blended, and then made into brick and shapes for use in furnace construction. [Italics supplied.]

* * * * *

[2072] ADMINISTRATION OF THE ALLOWANCE OF PERCENTAGE DEPLETION OF REFRACTORY MINERALS

The refractory industry has generally adopted the view that "ordinary treatment processes" as that term is used in the Internal Revenue Code, section 114(b)4(B), includes in the term "mining," in the case of refractory and fire clays and quartzite, the process of crushing, grinding, screening, and blending of the raw minerals.

Regulations 111, section 29.23(m)–1(f) as amended by the Treasury Department on July 14, 1953 are not inconsistent with the view of the industry.

* * * * *

The industry further believes that the attitude of its members as to the technical provisions relating to the computation of percentage depletion has been fair and reasonable. The industry, therefore, respectfully submits that the present percentage depletion provisions relating to refractory and fire clays and quartzite should be retained in their present form and urges your committee to adopt this conclusion in its consideration of possible amendments to the Internal Revenue Code.

* * * * *

H. Rep. No. 1337

(83d Cong., 2d Sess. (1954) (on Internal Revenue Code of 1954, H.R. 8300) (3 U.S.C. Cong. & Adm. News (1954) (4017, 4084))

[58] B. *Definition of income from property (sec. 613(c))*

Under present law and the bill, the gross income rates referred to above are applied to "gross income from the property." This is defined as gross income from mining, and "mining" in turn is defined as the

extraction of the minerals, the "ordinary treatment processes" normally applied to obtain commercially marketable mineral products and certain transportation. Present law also lists a number of specific processes that are considered to be ordinary treatment processes.

The bill continues these definitions except in three respects. In the case of magnesite, burning is to be regarded as an ordinary "treatment process" and in the case of talc, fine pulverizing is to be regarded as such a process. The present definition of "sulfur processing" is specifically related to the Frasch process, so that the general rule for ordinary treatment processes is to be available for sulfur produced in other ways.

* * * * *

[A183] *Section 613. Percentage depletion.*

* * * * *

[A185] Subsection (c) corresponds to section 114 (b)(4)(B) of the 1939 Code. Under existing law, the percentage rate of depletion is applied to "gross income from the property" and that term is defined in present law to mean in the case of a property other than an oil or gas well, the gross income from "mining." The term "mining" is defined in present law to mean not merely the extraction of the ores or minerals from the ground but also certain "ordinary treatment processes" applied by mine owners or operators and certain specified transportation. Existing law provides for separate categories of specific processes which are considered to be included within the term "ordinary treatment processes." The processes specified in the case of sulfur have been amended to indicate that the specified processes apply only to the recovery of sulfur by the Frasch process. In certain cases, sulfur may be recovered by

processes other than those specified in existing law which, in appropriate cases, may also be treated as "ordinary treatment processes."

In addition, this subsection amends existing law to specifically provide that the term "ordinary treatment processes" includes the pulverization of talc and the burning of magnesite.

* * * * *

S. Rep. No. 1622

(83d Cong., 2d Sess. (1954) (On Internal Revenue Code of 1954, H.R. 8300) (3 U.S.C. Cong. & Adm. News (1954) 4621, 4711))

[79] B. *Definition of Income from Property (sec. 613(c)).*

(1) *House changes accepted by committee.*

* * * * *

(2) *Changes made by committee.*

The term "ordinary treatment processes" in the case of coal was extended by the Committee to include "dust allaying and treating to prevent freezing." The latter process is now allowed under regulations. Also in the case of phosphate rock, "sintering and nodulizing" are included as an ordinary treatment process.

C. *Mine Tailings (sec. 613).*

(1) *House changes accepted by committee.*

Depletion allowances under present law are allowed with respect to mines and natural deposits. The House and your committee's bill extends percentage depletion at the appropriate rates to mine owners for minerals recovered from the residue that had accumulated from their mine. The provision does not apply in the case of a purchaser of such waste or residue or to a purchaser or rights thereto.

* * * * *

[332] Section 613(c) of the bill as passed by the House corresponds to section 114(b)(4)(B) of the 1939 Code, under which the rate of percentage depletion is applied to "gross income from the property," and that term is defined to mean, in the case of a property other than an oil or gas well, the gross income from "mining." The term "mining" in existing law is defined to mean not merely the extraction of ores or minerals from the ground but also certain "ordinary treatment processes" applied by mine owners or operators and certain specified transportation. Existing law provides four separate categories of specific processes which are considered to be included within the term "ordinary treatment processes." The House bill amended existing law with respect to sulfur to indicate that the specified processes apply only to the recovery of sulfur by the Frasch process. In cases where sulfur is recovered by processes other than the Frasch process, such other processes will be allowed or disallowed as "ordinary treatment processes" in accordance with the general provisions of section 613(c). Your committee has amended section 613(c)(4)(A) to provide that in the case of coal dust allaying and treating to prevent freezing are considered ordinary treatment processes. The House bill amended existing law specifically to provide that the term "ordinary treatment processes" includes the pulverization of talc and the burning of magnesite. Your committee has added to this list "the sintering [333] and nodulizing of phosphate rock." In the case of uranium the gross income from the property for purposes of applying the percentage depletion allowance will be determined by reducing the sale price of the ore by the net transportation cost of the taxpayer. For this purpose, the net transportation cost means the taxpayer's transportation cost reduced by

the hauling allowance allowed by the Atomic Energy Commission.

* * * * *

H. Conference Rep. No. 2543

(83d Cong., 2d Sess. (1954) (on Internal Revenue Code of 1954, H.R. 8300) (3 U.S.C. Cong. & Adm. News (1954) 5280, 5313))

[52] Amendment No. 148: The House bill provided the following ordinary treatment processes in the case of coal: Cleaning, breaking, [53] sizing, and loading for shipment. The Senate amendment extends this list to include dust allaying and treating to prevent freezing. The House recedes.

Amendment No. 149: This amendment provides that sintering and nodulizing are ordinary treatment processes in the case of phosphate rock. The House recedes.

Part II: Additional Legislative Materials: Excerpts from Hearings and Debates Indicating the Commercially Marketable Products to which the Proponents of Legislation had Reference in Seeking Percentage Depletion in relation to Particular Minerals.

ASBESTOS

(Percentage depletion first allowed beginning with 1951)

Senate Hearings, 1951

(The Revenue Act of 1951, Hearings before the Committee on Finance, United States Senate, 82d Cong., 1st Sess., on H.R. 4473)

[866] Statement of M. V. ENGELBACK, Manager, Field Engineering, The Ruberoid Co.

* * * * *

Asbestos is the only known mineral fiber, and the only known incombustible fiber. It occurs in several types, and its grades are based on fiber length. * * *

* * * * *

[867] Asbestos is extremely scarce and hard to find in America. The only known deposits of commercial value are found in Georgia, Arizona, and Vermont. And just one mine in Vermont provides about 97 percent of our domestic production.

* * * * *

Asbestos mining is in the category of a "low grade" mining venture. In order to recover our Vermont production 1949 of only about 43,000 tons, we had to mine and process approximately 1,000,000 tons of ore, to say nothing of removal of waste. The average asbestos yield amounts to only 4 to 6 percent recovery.

Senator MILLIKIN. Is it a surface deposit, or do you mine it?

Mr. ENGELBACK. At present, it is a quarry operation, but shortly we shall have to go underground. In Arizona, it is an underground operation, but that accounts for practically nothing, sir.

Of that total the small amount of only 4 to 5 percent can be called long fiber, if we happen to find any at all.

* * * * *

[868] * * * We cannot choose to mine either long fiber or short fiber. We have to take what comes. The only method of *separating* grades of fiber is by a highly specialized *milling* operation. [Italics supplied.]

* * * * *

We wish to point out that while certain grades of asbestos are used as a component part of some build-

ing materials, asbestos fiber itself is not a building material, and should not be classified as such. It is a *raw material* of innumerable uses in industry, as are many other metals and nonmetallic minerals which are granted allowances of 15 to 20 percent or more. [Italics supplied.]

* * * * * *

BARITE

(Percentage depletion first allowed beginning with 1944)

Senate Hearings, 1943

(Senate Hearings, Revenue Act of 1943)

[968] Statement of JOHN S. HALE, Jamestown, Tenn. * * *

Mr. HALE, Mr. Chairman, and members of the committee; I represent two small mining companies in Tennessee, Jamestown, Tenn., and we mine barites, * * *

* * * * * *

* * * We find it in residual clay formation, and it is in there in the form of sand and boulders and gravel, and we have to take it from those clay forms and *wash* it. Barites has a high specific gravity, and we separate it by a *gravitation process.* * * * [Italics supplied.]

* * * * * *

House Hearing, 1947

(House Hearing, Percentage Depletion (1947))

* * * * * *

[1] Statement of MALCOLM TARVER, representing the committee on taxation, barite industry of the United States.

* * * * * *

[5] (The prepared statement referred to is as follows):

Statement of MALCOLM C. TARVER, representing the committee on taxation, barite industry, of the United States in support of H.R. 1993, and H.R. 3624, Eightieth Congress, First Session, by Mr. GEARHART, of California.

* * * * * *

MAINTENANCE OF BARITE MINING INDUSTRY ESSENTIAL TO NATIONAL DEFENSE

Barite has four principal uses: Oil well drilling mud; paints; chemicals; and glass. In war it is used in explosives, incendiary bombs, case-hardening airplane parts, primers for artillery shells, hydrogen-peroxide disinfectants, tracer bullets, signal flares, and other varied chemicals. * * *

* * * * * *

[6] PROFITABLE PRODUCTION CANNOT BE CONTINUED IF PRESENT AIDS TO PRODUCTION LAPSE

The cost of delivering a ton of barite from the Cartersville, Ga., area to the du Pont Co. at Newport, Del., is $15, composed of production cost of $8.51 per ton plus freight rate of $6.49 per ton. Nova Scotia producers are delivering barite to the du Pont Co. at the following cost:

Ore	$7.00
Duty	4.00
Ocean freight	3.00
Dock service	.75
Dock insurance, etc	.12
Railroad freight	.75
Total, Delaware	$15.62

* * * * * *

[7] SUPPORTING DATA—HISTORY OF BARITE MINING INDUSTRY

* * * * * *

There are herewith next appended statements collating data derived from certain authorities therein stated, showing the imports of *crude and ground barite* in the United States for the years 1900–44, inclusive, and the production of barites in the United States for the years 1900–45 inclusive, with data included in the last-mentioned table as to production in the State of Georgia in most of these years, the statements referred to follow on the next succeeding pages. [Italics supplied.]

* * * * * *

BENTONITE

(Percentage depletion first allowed beginning with 1947)

House Hearing, 1947

(House Hearing, Percentage Depletion (1947))

Statement of Richard D. Saylor, Washington representative of National Lead Co., representing bentonite interests.

* * * * * *

[66] Bentonite is a claylike substance which has been formed by the weathering or altering of volcanic ash.

* * * * * *

[67] Bentonite occurs in deposits from a few inches to several feet thick.

The stratified deposits are worked by the usual stripping methods. The overburden is 7 to 30 feet thick and is removed by scrapers and tractors, sup-

plemented by power shovels on beds that are deeply covered.

* * * * * *

In some places the usual underground mining methods are employed.

* * * * * *

The major markets for bentonite have been developed in the foundry and petroleum industries.

* * * * * *

Approximately 28 percent of the total output in 1945 was used for drilling mud, and the same percentage for foundries. A little over 25 percent was used for oil filtering and decolorizing the remainder. The remainder in a variety of miscellaneous uses, including cement, chemicals, and paints.

New developments are taking place for its use in plastics.

* * * * * *

In 1945, the total output was 573,998 short tons, having a value of approximately $3,770,000.

* * * * * *

Now, the margin of profit is small on a ton of bentonite. *In the crude form, bentonite sells for around $2 to $3 a ton. That has to be dried and processed and is then sold somewhere between $7.50 a ton and $16, depending upon the amount of purification and handling it has to go through.* [Italics supplied.]

* * * * * *

[68] Statement of Hon. FRANK A. BARRETT, representative in Congress from the State of Wyoming.

* * * * * *

Wyoming is the biggest producer of bentonite, as Mr. Saylor has just mentioned. It is a comparatively new industry in Wyoming and in the country. A number of young men have gone into that business in the past 5 years in our State.

We have several big operators. The National Lead Co., which Mr. Saylor represents, has a plant in our State.

The Wyadac Mining Co. has a big plant in the State, but this industry lends itself very well to small businesses, and within the last 6 months, two young men have invested $100,000 in a plant and in the purchase of mines containing bentonite.

* * * * *

Now, inasmuch as the main use of bentonite is for drilling purposes around the oil fields, *we have a ready market in the Rocky Mountain area for practically all the bentonite that can be mined in the area.* (Italics supplied.)

* * * * *

[69] Statement of Hon. FRANCIS CASE, a Representative in Congress from the State of South Dakota.

* * * * *

Bentonite, of course, does not have exactly the same mining problems as those rock nonmetallics like feldspar and spodumene, but it is similar in its mining problems and its uses to barite, barite being used as in oil-drilling mud the same as bentonite is, and in the Bureau of Mines' reports at least you find bentonite classed along with ball clay when they are talking of the various clays and the commercial problems that you have with them.

* * * * *

Senate Hearings, 1950

(Senate Hearings, Revenue Revisions of 1950)

[447] Statement of LOUIS H. HEYL, Vice President and General Manager, the Wyodak Chemical Co., Cleveland, Ohio.

* * * * *

We are miners and processors of bentonite clay. Under section 114(b) of the Internal Revenue Code,

the mining and processing of bentonite clay is granted certain exemptions in the form of percentage depletion along with several other mineral products.

* * * * *

[448]

* * * * *

It is therefore a definitely established fact that trucking bentonite *to the processing plants where it must be dried, granulated, or ground, is a vital portion of the processing steps necessary to develop it to its "first commercially marketable product" stage; that is, in dried, ground, or granulated form and packed in bags.* [Italics supplied.]

Senator MILLIKIN. Your first step does not change the character of the deposit in any way?

Mr. HEYL. None whatever; it just reduces the moisture.

Senator MILLIKIN. That is, cleaning it up, drying it, and putting it into a certain form?

[449] Mr. HEYL. That is correct.

* * * * *

* * * The bentonite processing industry is a comparatively small business conducted by the following companies: The American Colloid Co., Baroid Sales Co., the Black Hills Bentonite Co., the Eastern Clay Products Co., and ourselves, the Wyodak Chemical Co. We have letters from the four other producers stating that their *sales of bentonite, pulverized and in bags, amounted to from 93 to 99 percent of their total sales;* that granulated bentonite in bags accounted for from 1 to 2 percent of their total and that the small remainder consists entirely of crushed and dried bentonite shipped to commercial grinders for further processing. [Italics supplied.]

In our individual case, *98¼ percent of our total production sold is pulverized* and packed in bags and

1½ percent is granulated and packed in bags while the remainder, about one-quarter of 1 percent, is crushed and dried and is sold to others for final processing. [Italics supplied.]

Since the five producers listed above make up the entire bentonite industry and since such a small percentage is sold other than pulverized and packed in bags, or granulated and packed in bags, it is our logical contention that "the first marketable product" is bentonite, so processed and so packed. [Italics supplied.]

* * * * *

[450]

* * * * *

Senator MILLIKIN. So that from the time it leaves your processing plant you do not add anything to it?

Mr. HEYL. No, sir.

Senator MILLIKIN. But it would be useless unless you did process it in the way that you mention?

Mr. HEYL. Yes. That is true. But I believe we bear that out by proving that *about 98¼ percent of the sales are the pulverized or granulated bentonite.* Some prefer to have it granulated. It takes water a little more readily. [Italics supplied.]

Senator MILLIKIN. Could the driller of an oil well use your product if it were not processed?

Mr. HEYL. No; they could not. They have tried it, but can't use it until it is pulverized or granulated.

* * * * *

Senator MILLIKIN. Does the purchaser of your bentonite pay you from the processing plant? Or does he pay you from the mine?

Mr. HEYL. He pays for the material as finally processed, either pulverized or granulated.

Mr. CHAIRMAN. It is not marketable until you do that?

Mr. HEYL. No, sir, it is not.

* * * * *

BORAX

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[2887] Statement re extension of percentage depletion allowance to Borax, by American Potash and Chemical Corp., Searles Lake, Calif.

The purpose of this statement is to summarize the facts which support the extension to borax of the percentage depletion allowance which is now granted to a large number of so-called nonmetallic minerals by section 114(b)(4) of the Internal Revenue Code.

[2887] DESCRIPTION AND OCCURRENCE

Borax (tincal or tincalconate) is a natural compound found at the present time principally in California and Nevada. * * * It is a white powder readily soluble in water, producing a faintly alkaline solution.

Borax is found in the state of nature in a considerable variety of forms, such as brines in prehistoric desert lakes and in various rocks or ores known as colemanite, rasorite, kernorite, etc. *In commercial or trade parlance it is the crude or unrefined commercially marketable product derived from the application of various ordinary treatment processes to these brines and/or ores.* An important secondary product, boric acid, is obtained by the reaction of borax to sulphuric acid. In certain desert lake brines in California, borax is found in conjunction with such minerals as potash, thenardite (sodium sulphate) and trona which

have previously been granted percentage depletion. The commercial value of the borax is largely determined by the boron oxide content. [Italics supplied.]

The Minerals Yearbook of the Bureau of Mines for the year 1947 contains the following data with respect to the production of boron minerals in the United States:

* * * * * *

[2890]

* * * * * *

Exact comparable data on domestic prices for borax for various years are not available, inasmuch as freight costs are a very substantial element in the cost to the user or consumer, and the practices of the industry with respect to freight absorption, quotation of delivered prices or prices f.o.b. mill have varied considerably. Notwithstanding deviations in some years, the general price trend has been noticeably downward. The January 1, 1949, price of American Potash & Chemical Corp. for borax in bags per ton f.o.b. Trona, with no freight allowance, with $35.25 per ton, as compared with a price of $151 per ton in 1920. Of this 1949 price, $4 per ton represents charge for bags.

* * * * * *

[The above statement was also presented at the Senate Hearings in 1951 (The Revenue Act of 1951, Hearings before the Committee on Finance, United States Senate, 82d Cong., 1st Sess., on H.R. 4473 (1951), p. 1060).]

CALCIUM CARBONATES

(See "LIMESTONE: ALL GRADES * * *", *infra*, pp. 363–381)

CLAM SHELLS

(See "SHELLS", *infra*, pp. 418–423.)

CLAY: BALL

(Percentage depletion first allowed beginning with 1942)

Senate Debate, 1942

(88 Cong. Record (Part 6), 77th Cong., 2d Sess.)

[8021] Mr. MCKELLAR. Mr. President, this amendment would put certain materials on the same basis as coal, oil, fluorspar, and other things which are given depletion allowances. Ball clay is used in making earthenware, various kinds of plumbing fixtures, and many other things which are useful both in the Army and Navy, and in the war effort generally, and also in our everyday life.

* * * * *

The clay-mining company does no manufacturing. It sells to manufacturers of dishes for domestic use, such as * * *. These dishes are the vitrified type, similar to those used in hotels. [Italics supplied.]

* * * * *

Another important outlet for clay from the mines is the manufacturing of sanitary wares, plumbing fixtures, made by such firms as Standard Sanitary, Kohler, Crane, Universal, Sanitary Manufacturing Co., and others.

* * * * *

The particular kind of clay I am seeking to have covered is found in great quantities in the States of Kentucky, Tennessee, Missouri, and perhaps others.
* * *

* * * * *

[8023] Mr. BARKLEY.

* * * * *

Ball and sagger clay is a peculiar type of clay from which porcelain is made. * * * In order to mine it the surface of the earth above it must be stripped away. * * *

* * * * *

Ball and sagger clay is not the type of clay out of which ordinary earthenware vessels are made. It is a very highgrade, peculiar, special type of clay. The trade name is ball and sagger clay, which is well understood in the trade. It is a clay out of which a very fine type of porcelain is manufactured. *It is shipped from small clay mines or pits to factories where the porcelain is manufactured.* As I have already stated, much of it is now being used to manufacture insulation, which is necessary to the war effort. [Italics supplied.]

The clay pits are all owned by local interests. No large corporations own any of them. That fact has nothing to do with the merits of the case; but the corporations are all small and are owned by local interests.

Prospecting for this type of clay is done partly by machinery and partly by hand. The earth above the clay is removed, as in the case of a strip coal mine. The earth is moved away, and the clay is exposed so that it can be mined by machinery and shipped to factories.

House Hearing, 1947

(House Hearing, Percentage Depletion (1947))

[63] Statement of F. L. CAROTHERS, Paris, Tenn., representing the Ball Clay Interests.

* * * * *

I come here to represent the seven principal producers of ball clay. Ball clay is a trade name given to a certain type of clay years and years ago.

It means a clay that is fine of texture, plastic, and when fired, burns to a white, attractive, or acceptable color.

Ball clay is used in making dishes. We use it on our tables, in bathroom fixtures, cooking utensils; it is used in floating enamels, making refractories necessary for the forming of glass, iron and steel, and many other things that are formed in high-temperature refractories.

Ball clay is used in all types of ceramic insulation.

* * * * *

It so happens that these seven companies produce every year from 94 to 96 percent of the ball clay that is produced in the United States, according to the figures compiled by the Bureau of Mines.

Now, I come here representing a rather odd industry. It is a rather small industry in dollar volume. It is a small industry in tonnage, and our prices per ton are comparatively low.

In 1940, the total dollar volume of ball clay produced in the United States was $1,065,503.

Ninety-five percent of that material was produced in these western districts of Kentucky and Tennessee.

* * * * *

[65] Mr. CAROTHERS. The average price per ton in 1940 was $7.37 for the entire industry. Some of our companies go 70 feet in the ground before they get any place.

In 1946, it was $9.85.

* * * * *

Mr. CAROTHERS. *There is some clay exported from this country to South America.* We exported a car the other day to Greece. [Italics supplied.]

* * * * *

[66] Mr. SIMPSON. Mr. Carothers, you are speaking

only of a small amount of the clay consumed in this country, are you not?

Mr. CAROTHERS. Oh, yes. The ball clay is a very small part of the clay. In other words, that does not take in the clay that a brick house is made out of.

* * * * * *

Mr. ELLIS. Mr. Carothers, all of what you term "ball clay" is not all the clay that goes into the manufacture of tableware, is it?

Mr. CAROTHERS. No, sir; China clay.

* * * * * *

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[441] Statement of E. A. GARBER, President, Harbison-Walker Refractories Corp., Pittsburgh, Pa.

Mr. GARBER. I not only represent Harbison-Walker, but over 50 refractories who produce about 90 percent of the refractory or fire material used in the United States. * * *

* * * * * *

[463] Mr. SIMPSON. Mr. Garber, your clay [refractory and fire clay] is distinguished from others we have heard of today, such as ball clay and sagger clay, is it? It can be distinguished from those clays?

Mr. GARBER. Yes, sir; due to the fact that it is used for an entirely different purpose.

* * * * * *

Senate Hearings, 1951

(Senate Hearings, Revenue Act of 1951)

[915]

* * * * * *

Statement of EDWARD J. GRASSMAN.

* * * * * *

We were taken care of in the act of the Eightieth Congress, 1946 and there has been no change made,

so I am here to answer any questions you may wish to ask, but also on behalf of some of my friends in the ball and sagger clay industry. We would like to ask, on their behalf, that the wording of section 304 on the twentieth line——

Senator BUTLER. What page?

Mr. GRASSMAN. Page 85. We ask that the wording be changed. We want the "and" stricken from the twentieth line and a comma inserted, and then it will be the same as the existing legislation. The present legislation says, "ball, sagger, and china clay."

We are afraid that the Treasury Department may contend under the present wording "ball and sagger clay, china clay"—that unless it was both a ball and a sagger clay it might not be allowed depletion.

* * * * *

CLAY: BRICK AND TILE

(Percentage depletion first allowed beginning with 1951)

Senate Hearings, 1951

(Senate Hearings, Revenue Act of 1951)

[1025]

* * * * *

ALBERHILL COAL AND CLAY CO.,
Los Angeles, Calif., July 3, 1951.

In re percentage depletion allowance for clays.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR GEORGE: On June 8, 1951, I wrote a letter to the Honorable Robert L. Doughton, chairman of the House Ways and Means Committee on the subject of technical clarification of the allowances for percentage depletion for brick and tile clay and

refractory and fire clay as provided in the new tax bill under consideration at that time. Mr. Doughton acknowledged receipt of my letter but it evidently arrived too late for the matter to be investigated and a change made in the tax bill.

As passed by the House of Representatives, the new tax bill allows percentage depletion of 5 percent for "brick and tile clay" and 15 percent for "refractory and fire clay". I assume the two different percentage figures have been used on the theory that "brick and tile clays" are more plentiful than "refractory and fire clays." The suggestion behind the wording used is that the end use of a clay shall determine the percentage grouping into which it shall fall.

The use of these terms does not make a definable grouping of clay products that can be segregated one from the other or is related to the supply of clay available for the manufacture of the products in either group. May I briefly illustrate these two points. First, the word "brick" includes firebrick as well as common brick. Firebrick are also refractories. Second, the word "tile" includes glazed bathroom tile as well as drain tile. Glazed bathroom tile are made from clays in relatively short supply and drain tile from clays that are plentiful. Further, many of the same clays are used in brick, tile, refractories and fire clay. For these reasons the end use yardstick of segregating clays for percentage depletion purposes will only create confusion in administering the law and will divide clays in a manner not related to scarcity or plentiful supply. It is conceivable that under the present wording of the proposed law the higher refractory clays made into many clay products would not be allowed any percentage depletion since on the face of it these clay products are not included in the definition of any of the clay products named.

I assume from the particular wording of the proposed bill that an attempt is being made to separate low grade clays that are mainly used for the manufacture of the class of low temperature fired clay products such as common brick and [1026] drain tile from the more refractory clays that are necessary for the manufacture of higher temperature fired clay products such as fire brick, face brick, flue lining, sewer pipe, conduit, pottery, glazed bathroom tile, etc.

Common brick and drain tile clays are sometimes mixed with the more refractory type of clays to manufacture some higher temperature fired clay products. Common brick and drain tile clay is generally a surface alluvial or adobe clay and is very common and plentiful in most parts of the United States. Large tonnages of this type of clay are used. The more refractory type of clays necessary for the manufacture of the higher temperature fired clay products are more rare and are only found in a limited number of localities. This type of clay is used in much less tonnage than the common brick and drain tile type of clay.

The easiest to define difference between these two types of clays is in their relative fusing temperature, that is the temperature at which the clays would fuse or melt. * * *

* * * * *

I suggest in the proposed tax bill that the wording "Clays with a fusion point of the pyrometric cone equivalent of cone 5 or less" be used in place of "brick and tile clay" in the 5 percent depletion allowance group and "clays with a fusion point above the pyrometric cone equivalent of cone 5" be used in place of "refractory and fire clays" in the 15 percent depletion allowance group.

* * * * *

Use of either of the above definitions will not affect depletion allowances now provided for ball, sagger, and china clay. These three clays have a fusion point above the pyrometric cone equivalent of cone 5 and would fall in the 15 percent depletion group as under the present law.

Very truly yours,

CHAS. J. BIDDLE, *President.*

Copies mailed to Senators William F. Knowland and Richard M. Nixon and Mr. Colin Stam.

* * * * * *

CLAY: CHINA

(Percentage depletion first allowed beginning with 1947)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[329]

* * * * *

The total sales of china clay in 1947 were only $17,000,000. The average price received for china clay, as marketed in 1947, was $12 per ton, f.o.b. mines. This is not the kind of nonmetallic mineral which the Treasury Department was referring to when it mentioned nonmetallic minerals costing 1 cent or less per ton in the ground.

Over half (54 percent in 1947) of the china clay produced goes into paper making. Clay imparts to paper opacity and a desirable finish and printing surface. Most paper used in printing contains some clay.

* * * * *

About 12 percent of china clay produced goes into rubber compounding. It is used in the manufacture of rubber to produce such products as rubber heels

and soles, rubber insulated wire and cable, jar rings, tires, plumbing supplies, doors stops, toys and a multitude of other products.

Another important use of china clay can be classified generally as use for ceramics, including refractory material, pottery and stoneware. These uses are well known and little purpose would be served in a further explanation.

* * * * *

CLAY: REFRACTORY AND FIRE

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[441] Statement of E. A. GARBER, President, Harbison-Walker Refractories Corp., Pittsburgh, Pa.

Mr. GARBER. I not only represent Harbison-Walker, but over 50 refractories who produce about 90 percent of the refractory or fire material used in the United States. Next to agriculture, we probably are the second basic industry in the United States. Our products are used in every phase of industry where heat resistance is necessary.

* * * * *

[442] Mr. GARBER. Coal, oil and gas, and many minerals, both metallic and nonmetallic, are granted percentage depletion in lieu of cost or discovery-value depletion under the existing provisions of the Internal Revenue Code. Among such minerals are ball, sagger, and china clay; bauxite; bentonite; and vermiculite.

However, refractory clays and quartzite are not granted percentage depletion, nothwithstanding the following facts:

* * * * *

(c) Most refractory clays are abstracted from the earth by underground mining methods similar to those employed in the recovery of coal. Some refractory clays and most refractory quartzite are recovered from open-pit mining operations, as are many metallic and nonmetallic minerals including ball, sagger, and china clay; bentonite; and most bauxite.

(d) Refractory clays have characteristics similar to ball, sagger, and china clay; bauxite; bentonite; and vermiculite, which are granted percentage depletion, and which have uses for refractory purposes.

* * * * * * *

* * * "Refractory clay" is a term considered to include types of clay known as refractory flint, diaspore and burley clays, bond or plastic clays, and kaolin. "Quartzite" is considered to include the rock sometimes called ganister. The locations of the areas within which deposits of refractory clays and quartzite occur, and the locations of plants in which refractory products are manufactured from refractory clays and quartzite, are shown upon the attached maps.

[449] Statement in Support of Percentage Depletion for Refractory Clays and Quartzite.

Synopsis

The following statement is made in support of the request of the refractories industry that percentage depletion be granted to the refractory minerals, refractory clays and quartzite, on the same basis as such depletion is granted to other nonmetallic minerals under section 114(b)(4) of the Internal Revenue Code. Refractory clays and quartzite are now granted depletion only on the basis of cost or discovery value, whereas other nonmetallic and metallic minerals have been allowed depletion at the rate of 15 percent of gross income.

This statement gives a discussion of the refractory *minerals as the raw materials* of the refractories industry, their description and occurrence, methods of mining, milling, and processing, statistics of the industry and the reasons why percentage depletion should be granted at the rate of 15 percent. [Italics supplied.]

From these data the discrimination in respect of percentage depletion, which presently exists against the producers of refractory minerals, is made clear and facts are furnished to show that every reason given in support of percentage depletion for the mineral products now covered exists in the case of the refractory minerals, and also, that from the standpoint of public policy and national defense, equal if not more urgent reasons exist for inclusion of the refractory minerals.

REFRACTORIES AND REFRACTORY MINERALS

Refractories

* * * * * *

A list of the manufacturers of refractory products who may qualify for percentage depletion benefits is given as exhibit I. Pertinent statitistics concerning the refractories industry are tabulated in exhibit II. The locations of the plants in which clay and silica refractories are manufactured are shown on the accompanying map of the United States, exhibit III.

Refractory minerals

There is no single descriptive word which may be used to name, without considerable definition, the minerals used in the refractories industry for the manufacture of refractories. The industry deems, however, that the phrase "refractory clays and quartzite" will

encompass such minerals without including deposits of clays and silica rock not used for refractories.

Chemically, refractory minerals must be pure. That is, they must be low in such impurities as iron oxide, lime or alkalies, which lower their melting points and render them uselesss for refractories. The term "refractory" modifying the words "clays and quartzite" has been suggested to embrace only the distinctively refractory minerals which fuse only at the highest temperatures. The terms "clay", "kaolin" and "quartzite," when used without the modifying term "refractory", include many materials having characteristics and properties which prohibit their use as refractories.

Several of these distinctively refractory minerals are already included among the minerals with respect to which percentage depletion is granted by existing law, viz, sagger clay, china clay, ball clay, and bauxite. [450] The following types of clay and silica-bearing rock are mined and used by the refractories industry, and those so used are considered to be embraced by the words "refractory clays and quartzite": Flint clay, including diaspore clay and burley clay; bond or plastic clay; kaolin; quartzite.

The clays thus mined are sometimes also referred to as "fire clay" but this term also embraces clays which are not distinctively refractory minerals. Similarly, the term "quartzite" covers types widely used for purposes other than refractories. The refractory types, as stated, are chemically purer and melt only at the highest temperatures. [Italics supplied.]

* * * * *

[453]

* * * * *

* * * Among the materials granted percentage depletion in section 114(b)(4), those having characteris-

ties similar to refractory clay and in some cases having uses for refractory purposes are the following: sagger clay, bauxite, china clay, ball clay, bentonite, vermiculite.

* * * * *

[455]

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THE PROPOSED AMENDMENTS

To provide percentage depletion for refractory clays and quartzite with respect to taxable years beginning after December 31, 1948, the following amendments to section 114 of the Internal Revenue Code are proposed.

* * * * *

4. Amend section 114(*b*)(*4*)(*B*) by inserting the words "refractory clays and quartzite" after the words "ball and sagger clay."

EXHIBIT I

Manufacturers of refractory clay and silica refractories who may qualify for percentage-depletion benefits.

[This list includes producers of more than 80 percent of the output of the industry.]

* * * * *

[*This list contains the names of 67 manufacturers and the addresses of their refractory plants.*]

[456]

* * * * *

EXHIBIT II

Estimate of depletion allowance to manufacturers of clay and silica refractories based on percentage depletion of 15 percent.

	Year 1947	Year 1948
Number of establishments (approximately)	240	240
Manufactured value of refractory clay and silica products	$137,000,000	$165,000,000
Raw materials used (refractory clay and quartzite):		
Tonnage (net)	5,400,000	5,200,000
Value	29,400,000	35,400,000
Estimated depletion allowance:		
(a) *Basis:*		
15 percent of value	4,410,000	5,310,000
Federal tax (38 percent)	1,675,800	2,017,800
(b) Basis:		
One-half of net income	3,025,000	3,328,000
Federal tax (38 percent)	1,149,500	1,262,800

Note.—(b) basis would apply, being less than (a) basis [Italics supplied.]

[463] Mr. SIMPSON. Mr. Garber, your clay is distinguished from others we have heard of today, such as ball clay and sagger clay, is it? It can be distinguished from those clays?

Mr. GARBER. Yes, sir; due to the fact that it is used for an entirely different purpose.

* * * * * *

Mr. SIMPSON. What is it used for, principally?

Mr. GARBER. *The products we manufacture* are used for linings in blast furnaces, open hearth, coke oven, cement kilns, chemical plants, anywhere where heat is necessary to produce a product. [Italics supplied.]

* * * * *

Mr. JENKINS. You have three or four plants down in southern Ohio, down in my section.

Mr. GARBER. Yes, sir.

Mr. JENKINS. And your product comes out as regular bricks, does it not? You make bricks?

Mr. GARBER. We first mine the clay.

Mr. JENKINS. I know.

Mr. GARBER. Then we process it into bricks at high

temperatures. We burn the clay at high temperatures after forming.

* * * * *

[p. 464]

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Mr. GARBER. I speak for 95 percent of the industry. That is right.

* * * * *

House Hearings, 1953

(House Hearings, General Revenue Revision (1953))

[2070] Statement of RUSSELL P. HEUER, Representing the Refractories Institute.

Mr. HEUER. My name is Russell P. Heuer. I am vice president of General Refractories Co., Philadelphia, Pa. I represent the Refractories Institute, a national association of 87 refractory manufacturers, and this statement is made in behalf of its members and the entire refractories industry. I wish to cite the benefits to the national economy which have been derived from the granting of the allowance for percentage depletion to refractory and fire clays and quartzite by the 1951 Revenue Act and to urge the retention of this provision in its present form.

The specific Internal Revenue Code provision to which I refer is section 114(b)4(A), which was amended by Congress in Public Law 183, 82d Congress, 1st session, by the addition of "refractory and fire clays, quartzite" to the minerals subject to percentage depletion.

* * * * *

MINERALS USED IN THE MANUFACTURE OF REFRACTORIES

Refractory products are manufactured from carefully selected minerals, the chief minerals being refractory and *fire clay* and quartzite. The raw minerals are crushed, ground, and blended, and then made

into brick and shapes for use in furnace construction. [Italics supplied.]

* * * * *

[2072] ADMINISTRATION OF THE ALLOWANCE OF PERCENTAGE DEPLETION OF REFRACTORY MINERALS

The refractory industry has generally adopted the view that "ordinary treatment processes" as that term is used in the Internal Revenue Code, section 114(b)4(B), includes in the term "mining," in the case of refractory and fire clays and quartzite, the process of crushing, grinding, screening, and blending of the raw minerals.

Regulations 111, section 29.23 (m)–1(f) as amended by the Treasury Department on July 14, 1953 are not inconsistent with the view of the industry.

* * * * *

The industry further believes that the attitude of its members as to the technical provisions relating to the computation of percentage depletion has been fair and reasonable. The industry, therefore, respectfully submits that the present percentage depletion provisions relating to refractory and fire clays and quartzite should be retained in their present form and urges your committee to adopt this conclusion in its consideration of possible amendments to the Internal Revenue Code.

* * * * *

COAL

(Percentage depletion first allowed beginning with 1932)

Senate Hearings, 1954

(Internal Revenue Code of 1954, Hearings before the Committee on Finance, United States Senate, 83d Cong., 2d Sess.)

[1409] Statement of W. BRICE O'BRIEN, Assistant Counsel, National Coal Association, accompanied by Lovell H. Parker, Chairman, Tax Committee.

Mr. O'BRIEN. Mr. Chairman, my name is W. Brice O'Brien. I am assistant counsel of the National Coal Association, representing bituminous coal producers throughout the Nation. I am accompanied by Mr. Lovell H. Parker, chairman of the association's tax committee.

* * * * * *

We are advocating, on behalf of the coal industry, four amendments to H.R. 8300—dealing with dust allaying and antifreeze treatment of coal, * * *. However, because of time limitations, we will discuss here only the amendment dealing with dust allaying and antifreeze treatment of coal. We ask that our written statement, dealing in detail with all four recommendations, be made a part of the record of these hearings.

The CHAIRMAN. That will be done.

(The statement referred to follows Mr. O'BRIEN's testimony.)

Mr. O'BRIEN. In the decade beginning in 1930 dust-allaying treatment was developed on a broad scale to combat the alarming trend away from coal as a domestic fuel. This technique has been only partially successful, as evidenced by the fact that in the last 10 years the retail deliveries of bituminous coal have been cut almost in half. Nevertheless, if any part of the domestic market is to be retained, the coal which serves that market will have to be dust-treated. The industry is having an extremely difficult time selling coal to the householder even with dust treatment. If we must sell dusty coal, our job is utterly hopeless. Without dust-allaying treatment, it is prac-

tically impossible to sell coal for domestic heating purposes.

Section 114(b)(4)(B) was added to the Internal Revenue Code in 1943. This section provides a definition of gross income from the property, upon which percentage depletion is based. This definition is carried over in subsection (c) of section 613 of H.R. 8300.

Under the definition, "gross income from the property" means the gross income from mining. The provision specifies that "mining" includes not merely the extraction of the ores or minerals from the ground but also the "ordinary treatment processes" normally applied in order to obtain the commercially marketable product or products. The provision further specifies that ordinary treatment processes include the following:

In the case of coal—cleaning, breaking, sizing, and loading for shipment.

In *Black Mountain Corporation* v. *Commissioner* (21 T.C. No. 83), promulgated February 25, 1954, the Tax Court held—with Judge Arundell dissenting—that the application of a fine oil spray or mist to coal for the purpose of allaying dust is not an ordinary treatment process within the meaning of the statute. The Tax Court held, therefore, that the gross income from the property upon which percentage depletion is based must be reduced by the amount of gross income from the dust-allaying treatment and that the net income from the property which also provides a limitation on percentage depletion must be reduced by any profit involved in the dust-allaying treatment.

[1410] This decision was promulgated too late for us to bring this matter to the attention of the Ways and Means Committee. We ask, therefore, that this

committee amend subsection (c)(4)(A) of section 613 of H.R. 8300 to read as follows:

In the case of coal—cleaning, breaking, sizing, dust-allaying and antifreeze treatment, and loading for shipment.

The CHAIRMAN. Anti what?

Mr. O'BRIEN. Antifreeze.

The CHAIRMAN. Tell us about that.

Mr. O'BRIEN. When coal is shipped in the northern parts of the country during the winter months, it is necessary to use certain chemicals or other materials—I believe calcium chloride is the most common—when the coal is loaded on the car, to keep the coal from freezing in the car. Without such treatment in the cold months it would be very difficult to get the coal out of the car. It freezes I believe primarily in the corners of the car.

The CHAIRMAN. Is that a common practice?

Mr. O'BRIEN. It is.

The CHAIRMAN. What is the percentage of coal sold subjected to that practice?

Mr. O'BRIEN. It depends upon the weather at the time of shipment. If the weather is below freezing at the time of shipment, it is my understanding that all of the coal in that climate is treated for antifreeze. But coal shipped in the summertime, of course, is not so treated.

Unfortunately, I am unable to give you figures as to the percentage of the total production.

The CHAIRMAN. Well, is it a common practice?

Mr. O'BRIEN. It is, sir. It is universal.

The CHAIRMAN. All right.

Mr. O'BRIEN. With respect to the dust treatment, the Tax Court recognized, in the Black Mountain decision, the following important facts:

On the average, only 11 pounds of oil are applied to 2,000 pounds of coal, and the oil so applied does not add to the burning qualities of the coal in any measurable amount. In other words, the burning qualities of the coal are not beneficiated by the oil treatment. The purpose of the oil treatment is primarily and purely to allay the dust which would otherwise be so annoying to the householder.

The CHAIRMAN. What percentage of your coal is customarily subjected to that treatment?

Mr. O'BRIEN. In the last year for which figures were available—I believe that was 1949—some 41 million tons of coal were subjected to the dust-allaying treatment.

The CHAIRMAN. Out of a total of how much?

[1411] Mr. O'BRIEN. Out of a total of 465 million tons—approximately 9 percent.

The CHAIRMAN. You say it is about 9 percent?

Mr. O'BRIEN. Yes, sir. The point is, however, that that 9 percent of total production represents, as near as we can judge, somewhere over 90 percent of the coal which goes to the domestic home. Retail deliveries of coal in that year amounted to about 65 to 70 million tons. But retail deliveries include not only domestic coal, but includes also coal to the small industrials and to the hotels and large apartment houses.

Now, much of that coal it is not necessary to dust treat. It is necessary to dust treat over 90 percent of the coal which goes into the home.

Government figures aren't available as to the exact percentage of home coal which is dust treated. The reason for that is that there is no breakdown in the amount of retail deliveries between homes and these small industrials. Our sales people are convinced, however, that practically all coal that goes into the

home is dust treated and must be dust treated in order to be sold.

The CHAIRMAN. Do you have any evidence of that in the House?

Mr. O'BRIEN. The only evidence on the point was opinion evidence which was presented to the Tax Court in the Black Mountain case in Chicago. They made no specific finding in their decision as to the percentage of domestic coal which is oil treated or dust treated. There is no available evidence other than opinion testimony of expert witnesses.

The CHAIRMAN. Is the treatment done by the mines or by the distributor?

Mr. O'BRIEN. The treatment is done at the mine. The Tax Court recognized that it is not feasible for this dust treatment to be done anywhere other than at the mine, before shipment. Early in the game, in the 1930's, when this treatment first developed, some retailers did try to apply their own dust treatment.

* * * * *

[1413]

* * * * *

The CHAIRMAN. I want to ask you another question: How usual is this in the business?

Mr. O'BRIEN. Only 9 percent of the total production is dust treated, approximately 9 percent or 10 percent. However, over 90 percent of coal which goes into homes is dust treated. Now, practically every mine of any size, practically everything but the gopher hole, has dust treatment equipment. They use that dust treatment equipment and process only for the coal which goes into the home.

I should correct that statement: In some cases they use it for other types of coal. I believe certain types of slack are dust treated, so it won't all blow away

during shipment. But primarily it is used almost totally for coal which goes into the home.

* * * * *

DIATOMACEOUS EARTH

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

* * * * *

[439] Statement of A. R. BOLLAERT, Vice President, Great Lakes Carbon Corp., New York.

* * * * *

[440] I am vice president and general manager of the Dicalite Division of Great Lakes Carbon Corp., who mine and process diatomaceous silica. I do not know whether many of you gentlemen know what diatomaceous silica is, and for your edification, a brief description would be that it is the siliceous skeleton or remains of marine plants or aquatic plants, inasmuch as it is found in both salt water and fresh water, from that origin.

* * * * *

For instance, we have vermiculite, feldspar, mica, talc, barite or sometimes called barites, china clay, and bentonite. Those materials are all *competitive to us* in one form or another, and inasmuch as these materials currently enjoy a percentage depletion under the Internal Revenue Code, we respectfully ask that the present discrimination be removed so that we can be truly competitive to these materials. [Italics supplied.]

[The above statement was also presented at the House Hearings in 1951 (Revenue Revision of 1951, Hearings before the Committee on Ways and Means,

House of Representatives, 82d Cong., 1st Sess.) (Part 3) (1951) p. 1649.]

DOLOMITE

(See "LIMESTONE: ALL GRADES * * * plus other stones, including dolomite, * * *", *infra*, pp. 363–381.)

FLUORSPAR

(Percentage depletion first allowed beginning with 1942)

Senate Debate, 1942

(88 Cong. Record (Part 6), 77th Cong., 2d Sess.)

[8023] Mr. BARKLEY. * * *

* * * * *

[8024] The Committee on Ways and Means included fluorspar in the depletion provision. Fluorspar is an absolutely indispensable *ingredient* in the manufacture of steel. It is produced in only a very few places. Ninety percent of it in the United States is produced in a little vein in southern Illinois and western Kentucky. * * * [Italics supplied.]

* * * * *

Mr. HATCH. I ask unanimous consent to have printed in the Record at this point a résumé of some of the salient points in the fluorspar industry.

Mr. BARKLEY. I shall be very glad to have it in the Record.

There being no objection, the statement was ordered to be printed in the Record, as follows:

BRIEF RÉSUMÉ OF SALIENT POINTS IN THE FLUORSPAR INDUSTRY

General: The principal producing areas are western Kentucky and southern Illinois along the Ohio River. These two areas have pro-

duced 90 to 95 percent of the total fluorspar produced in the country. There are two types of deposits, the flat lying bedded deposits in the cave-in rock area of Illinois and the vein type of deposits in Illinois and Kentucky. In the West there is production in New Mexico, Colorado, Utah and Arizona. Colorado and New Mexico seem to have the greatest possibility for increased production. All of this production is from vein types of deposits.

Grades: There are three grades of fluorspar. Metallurgical grade which has a minimum specification of 85 percent calcium fluoride, and a maximum specification of 5 percent silica. This material is used in the open hearth and electric steel furnaces and ordinarily the steel furnaces are unwilling to accept material which runs more than 15 percent fines. * * *

The ceramic grade of fluorspar has a minimum specification of 96 percent fluoride, a maximum specification of 3 percent silica, and a maximum specification of 0.12 percent iron oxide. *This material* must be *finely ground* and *is sold* to the enamel and glass industries. [Italics supplied.]

The acid grade of fluorspar is the highest commercial grade with the exception of the optical grade. This grade has a minimum specification of 98 percent calcium fluoride and a minimum specification of 1 percent silica. This specification is also shaded down to 97 and 1½. *It is also sold* in *ground* form to consumers who use it to make hydrofluoric acid from which a variety of other chemicals are manufactured. * * * [Italics supplied.]

* * * * *

Prices: Prices on all grades of fluorspar have been frozen as of the level existing on January 2, 1942. On the average, this means that the Illinois-Kentucky producers are receiving from $24 to $25 per short ton of metallurgical grade fluorspar, freight on board loading points. The

ceramic and acid grades are selling for from $32 to $34 per short ton. The western producers are handicapped by the amount of the freight from their mines to the Illinois-Kentucky area. In general, the price in New Mexico and Colorado for metallurgical grade is $17 to $18. The price of the acid grade ranges from $27 to $28.

* * * * * *

House Hearings, 1947

(House Hearing, Percentage Depletion (1947))

* * * * * *

[19] Statement Concerning Making Percentage Depletion for Fluorspar Permanent.

* * * * * *

[20] Fluorspar is a hard, transclucent, nonmetallic mineral that is found usually in veins and is mined through shaft and tunnels. In its pure form it is 51 percent calcium and 49 percent fluorine. It is a mineral which in color runs from white, light amethyst, canary yellow, bluish-green to deep purple. When ground for refining it is white with usually either a slight purplish or grayish cast.

Fluorspar ores are mined *and milled* by somewhat similar method to those employed for ores, such as those of the metals lead, zinc, and copper. Fluorspar deposits are found in about a dozen States. * * * [Italics supplied.]

Fluorspar was used first as ornaments by the Indians but it soon found a place in smelting of ores because it aids in making the slag produced in smelting the ores of iron, copper, etc., more fluid. Thus, its principal single use, tonnagewise, has been and still is as a flux in the manufacture of basic open-hearth steel.

Fluorspar is produced and used in three grades, designated as:

* * * * * *

[A similar statement entitled "Statement of Illinois-Kentucky Fluorspar Producers Committee" was presented at the House Hearings in 1950 (Revenue Revision of 1950, Hearings before the Committee on Ways and Means, House of Representatives, 81st Cong., 2d Sess. (vol. 1) (1950), pp. 475–476).]

FULLER'S EARTH

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1951

(House Hearings, Revenue Revision of 1951)

[1618] Statement of CHARLES E. GLASSER, President, General Reduction Co., Chicago, Ill.

Mr. GLASSER. I am Charles E. Glasser, president of the General Reduction Co., Chicago, Ill. Our company mines fuller's earth at Macon, Ga. I respectfully request the adoption of a depletion of 15 percent of gross income for fuller's earth mining operations, or a percentage amount equal to that given many other similar nonmetallic clays and minerals.

Fuller's earth is a nonmetallic mineral in the form of a plastic-type *clay used for* the clarification of vegetable, animal, and mineral oils. It is also used in the formulations of agricultural insecticides and fertilizers, the treatmnet of municipal and other water supplies, sewage, and waste, as well as in many other miscellaneous chemical and physical applications which contribute to the national safety, health, and interest, both in peace and wartimes. [Italics supplied.]

* * * * *

A 15-percent depletion has already been allowed most metals and several nonmetallic minerals, includ-

ing certain clays. Based upon [1619] existing regulations we are unable to determine whether or not fuller's earth is classified as one of the other clay products which are somewhat similar in chemical analysis and mining hazards and which are now granted a 15-percent depletion allowance. If it cannot be so classified then it is our opinion that fuller's earth should be specifically given a comparable 15-percent depletion rate.

From a competitive end-use angle some of the clay products other than fuller's earth which now have a 15-percent depletion for mining operations are used in the manufacture of agricultural insecticides which are of utmost importance during our present war effort in order to produce agricultural foods so necessary for the national safety, health, and interest, and for the full war effort.

Fuller's earth is also *widely used* for this purpose. Thus, it seems only fair that no discrimination should be made and unless fuller's earth can be classified along with these other clay products, the former should be granted a specific 15-percent allowance for depletion. [Italics supplied.]

* * * * *

Although fuller's earth is a very important resource there are relatively few deposits of this material being mined in the United States and for this reason consumption by important essential industries is comparatively small. The industry is operated by very few companies having relatively small capitalization. * * * In 1949 the Bureau of Mines reported only 320,906 short tons of *fuller's earth sold* at a value of $5,199,642 for all producers. [Italics supplied.]

* * * * *

GARNET

(Percentage depletion first allowed beginning with 1951)

Senate Debate, 1951

(97 Cong. Record (Part 9), 82d Cong., 1st Sess.)

[11724] *A. Percentage depletion*

* * * * *

[12218] Mr. IVES. Mr. President, I send to the desk an amendment and ask that it be read and considered at this time.

The PRESIDING OFFICER. The clerk will state the amendment offered by the Senator from New York.

The CHIEF CLERK. On page 162, line 7, it is proposed to insert after the word "beryl" the word "garnet."

* * * * *

Mr. IVES. Mr. President, I propose this amendment because of facts brought to my attention only a few days ago. The amendment would add garnet to those minerals granted depletion allowances under section 319(iii) of the committee bill.

Mr. James A. Barr, Chief of the Industrial Minerals Section of the Defense Minerals Administration, informed my office by phone on September 26 that the mineral called garnet was more highly strategic from the point of view of national defense than any mineral presently granted depletion allowances under the committee bill. Mr. Barr emphasized garnet's strategic importance primarily because of the very limited supply available in the United States, and the almost complete absence of stockpiled reserves.

On the basis of this information, I urge that this amendment, which would grant a 15-percent depletion allowance for garnet, be agreed to. I am particularly concerned with this problem because over 90 percent of the garnet mined in the United States comes from the State of New York, believe it or not.

At this point in my remarks, Mr. President, I ask unanimous consent to have printed in the body of the Record a description of the garnet industry in New York published by the New York State Department of Commerce.

There being no objection, the matter was ordered to be printed in the Record, as follows:

GARNET

New York has large reserves of high quality garnet ore accessible for surface mining. While competition from garnet mines situated in other States, and in foreign countries, has been negligible, the garnet industry has operated under handicaps in recent decades due to the rise of manufactured competitive products. Among the most important of these artificial abrasives are aluminum oxide (fused alumina) and silicon carbide. * * * Progress has been continuous in developing new methods of ore treatment and new forms of abrasive garnet. With such progress, the garnet industry will quite probably be able to compete successfully in many fields of abrasive requirements.

The mineral, garnet, is valuable because of its physical properties. Among the high grade natural abrasives, it ranks fourth in order of hardness, namely: diamonds, corundum, emery, garnet. * * * [Italics supplied.]

* * * * *

[12219]

TABLE 16.—*Abrasive garnet sold or used by producers, United States, 1900–1947*

	Annual average	Annual average
	Short tons	
1947	8,722	814,071

Source: Minerals Yearbook.

TABLE 17.—*Garnet, silicon carbide, and fused-alumina abrasives, average value per ton, selected years, 1920–46*

	1920	1930	1940	1946
Abrasive garnet [1]	$79.33	$62.79	$34.90	$73.64

[1] Average value of output sold or used by producers in the United States.

Source: Minerals Yearbook.

GRANITE

(Percentage depletion first allowed beginning with 1951)

(For granite other than dimension stone, see "LIMESTONE: All grades * * * plus other stones, including * * * granite * * *," *infra*, pp. 363–381.)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[2890] Statement of National Building Granite Quarries Association.

* * * * *

The *uses of granite* are many—building material, bridge material, crushed stone for the construction and road-building industry. Approximately 50 percent of it is used in street curbing. In the North, it is indispensable in road building and street curbing, because severe cold weather disintegrates concrete. Granite used to be used extensively for post-office buildings and railway stations. For example, here in

Washington, Memorial Bridge and the Fourteenth Street Bridge, as well as the Old Post Office Building were constructed with granite. The "fines" or millings from the quarries and mills are extensively used in the poultry business for the feeding of poultry, the individual bird needing the grit. An estimated 150,000 tons per annum are sold for this poultry grit. Granite grits are preferable to any other in the poultry business. [Italics supplied.]

* * * * * * *

Senate Hearings, 1951

(Senate Hearings, Revenue Act of 1951)

[1059] Statement of RALPH A. FLETCHER on behalf of National Building Granite Quarries Association, Inc.

* * * * * *

Granite is a natural resource, having been *commercially produced* in more than 75 percent of the States in the Union at one time or another. Although the material itself is common, deposits which are profitable to work under present conditions are not * * * [Italics supplied.]

The Bureau of Mines reports that in 1949 there were only 139 active producers in the United States, although in 1928 the same Bureau reported 464 active units. This is not a case of fewer having more as is instanced by the volume used in rough construction which decreased from 356,000 tons in 1928 to 55,000 tons in 1949, while in the same period *dressed architectural granite* dropped from 1,400,000 cubic feet to 540,000 cubic feet. [Italics supplied.]

* * * * * *

542090—60——24

(Senate Hearings, Internal Revenue Code of 1954)

[1213] Statement of WESLEY E. DISNEY, Washington, D.C., representing the National Building Granite Quarries Association, Inc.

* * * * * *

Mr. DISNEY. It is my pleasure to be here this morning. I represent the National Building Granite Quarries Association, Inc. You will recall that within recent years you gave granite 5 percent depletion. We are not squealing but we need some help.

At page 156 of the bill, at paragraph (f), we propose and hope the committee will adopt an amendment on this order, that—

> In case of granite, limestone, marble, sandstone, slate, and other natural stones, ordinary treatment processes shall include any of the following: Sawing, grinding, cutting, polishing, and otherwise fabricating to dimension.

Our proposed amendment may include others who are not interested in it, in which event the committee may be at liberty, so far as we are concerned, to eliminate the words "limestone, marble, sandstone, and slate," so as to make the amendment read:

> (f) In the case of granite and other natural stones, ordinary treatment processes shall include any of the following: Sawing, grinding, cutting, polishing, and otherwise fabricating to dimension.

* * * * * *

The *uses of granite* are many. For example, it is used as a building material, bridge material, crushed stone for construction and roadbuilding, street curbing, poultry feed, monuments, and other uses. Building material, usually under architectural specifica-

tions, is required to be processed to form. Likewise bridge material. Street curbing must undergo a process to shape it for uniformity. One member of our association makes large quantities of slabs or markers for cemetery uses. These are required to be within certain specifications by the War Department. [Italics supplied.]

We are led to believe that the Treasury has the impression that the point at which percentage depletion begins is that point at which the rough blocks of granite are loaded on cars or trucks at the quarry, and the transportation to the processing mills will not be allowed, nor will the milling of the rough blocks be allowed. * * *

* * * * *

[1214] There is a very good reason why this matter should be clarified by the Congress at this time. * * *

* * * * *

[1215] In general, the types of equipment used and the types of treatment processes applied for a particular use, are similar throughout the industry. From these facts, it appears that the "gross income from the property" in the case of a granite producer is the gross sales of the product, whether sold in the form or grade for building material, bridge material, crushed stone for construction and roadbuilding, street curbing, poultry feed, or monuments, or for any other use. The statute does not contemplate nor require a producer to change or disturb its ordinary and usual business operations.

* * * * *

Senator CARLSON. You mention that little granite would be sold as quarried. That would apply to most stones, wouldn't it?

Mr. DISNEY. That is right. Most of our granite has to be processed in order to sell it, at all. For instance, street curbings here in Washington. If you

go anyplace in Washington, you will find granite. In our area, they are concrete, but here they are granite and they have to be processed. There would be no sale for it at all in crude blocks as it comes from the quarry.

The CHAIRMAN. *Don't they have establishments that do nothing but the final finishing of the granite?* [Italics supplied.]

Mr. DISNEY. *Yes.* For instance, one mill I have visited up in Massachusetts, they have a huge quarry and they get the granite out in huge chunks in rough form and then it is moved over there 2 or 3 miles to a mill that has all the modern sawing and polishing equipment. [Italics supplied.]

The CHAIRMAN. Is that mill owned by the quarry?

Mr. DISNEY. Owned by the same corporation, yes, sir. It is a part of it.

GRAVEL

(See "SAND AND GRAVEL," *infra,* pp. 413–416).

IRON ORE

(Percentage depletion first allowed beginning with 1932)

Senate Hearings, 1942

(Senate Hearings, Revenue Act of 1942)

[982] Statement of M. D. HARBAUGH, Cleveland, Ohio, Vice President and Secretary, Lake Superior Iron Ore Association.

* * * * *

[985] Mr. HARBAUGH. If I understand your question, the commercial grades of iron ore at the present time average about 51½ percent iron.

Senator BROWN. Is it over 50 percent?

Mr. HARBAUGH. Yes.

Senator BROWN. Your low-bearing ores run around 35 to 38 percent?

Mr. HARBAUGH. They run upward of 30 percent and less than 40 percent. It is *necessary to concentrate that material,* of which there is an unlimited supply, in order to take the place of these commercial grades of ore which heretofore we have been able to mine by open-pit methods very simply and rapidly. If we had not had these open-pit ores at the present time for this war emergency, I do not know what we would have done, because it is mainly these mines that have been able to account for this very rapid expansion of output. [Italics supplied.]

* * * * *

[987] Senator DANAHER. What do you consider that word "representative" to mean, or what standard do you apply to decide whether it is a representative normal market price?

Mr. HARBAUGH. *The price of iron ore is a generally well known figure, a published figure. These operating companies that turn over their ore to the owners, operate at cost; they are not profit companies, you see, and therefore some market price would have to be established to determine what is a fair profit in that case.* In other words, there is no profit in the transaction as it is now recorded. It will be up to the Commissioner undoubtedly to determine what was the current, normal price, which could be easily determined from just the general published information about the industry. [Italics supplied.]

* * * * *

(Senate Hearings, Revenue Revisions of 1950)

[299] Statement of M. D. Harbaugh, Vice President, Lake Superior Iron Ore Association, Cleveland, Ohio.

* * * * *

[301] Section 204(c) of the bill, regarding percentage depletion, in revising the definition of gross income from mining, would create a deterrent that certainly will adversely affect the development of *low-grade ores* including the *taconites, which require beneficiation.* Plants cannot always be established directly at the property * * *. [Italics supplied.]

Senator MILLIKIN. How far would you carry the transportation cost?

Mr. HARBAUGH. Well, we have plants that are located several miles from the source of the ore, centralized plants which are necessarily large in which ores from numerous small pits or small workings can be treated.

Senator MILLIKIN. How do you treat the iron ore at those smaller plants?

Mr. HARBAUGH. The ore is treated in these plants by *washing* to remove some of the [impurities] and by *other concentration processes* such as are technically known as jigging and heavy density separation. [Italics supplied.]

Senator MILLIKIN. You are simply preparing the ores for the plant?

Mr. HARBAUGH. Yes, sir. *This part that is treated would not be marketable without this treatment.* [Italics supplied.]

Senator MILLIKIN: You would not run your cost down to Pittsburgh?

Mr. HARBAUGH. No. *This involves the transportation to the processing plant where we make the first marketable product.* [Italics supplied.]

Senator TAFT. And a product which can be shipped on boats?

Mr. HARBAUGH. Which can be shipped on boats and which is usable in the premises.

* * * * *

LIMESTONE: ALL GRADES (CALCIUM CARBONATES, METALLURGICAL AND CHEMICAL GRADE) PLUS OTHER STONES, INCLUDING DOLOMITE, GRANITE, MARBLE, AND SANDSTONE

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[480]

* * * * *

Statement of Russell Rarey, President, Marble Cliff Quarry Co., Columbus, Ohio.

Mr. RAREY. I would like to have about 5 minutes, if I may. We operate a limestone open quarry near Columbus, Ohio, and in the western part of the State a limestone underground mine. The quality of this stone we produce is such that it is marketed for chemical and metallurgical purposes, for burned lime, for agricultural use, for [481] railroad ballast, highway construction and maintenance, for building construction, and for various manufacturing and miscellaneous uses.

As a member of the executive committee and of the percentage depletion committee of the National Crushed Stone Association, *I have been authorized, along with Mr. Krause, to present a statement on behalf of the National Crushed Stone Association, and*

the Agricultural Limestone Institute. [Italics supplied.]

With your permission, Mr. Chairman, we would now like to file this formal statement for your consideration, and if I may I would like to emphasize the following few points.

The CHAIRMAN. Without objection, that will be done.

(The statement referred to follows.)

Satement in support of a percentage depletion allowance for producers of crushed stone.

(Prepared by National Crushed Stone Association and Agricultural Limestone Institute)

Crushed stone plays a vital part in the health and economic welfare of the Nation in both peace and war. The same or similar problems are encountered in the extracting, processing, and marketing of *crushed stone* as are encountered in the case of those minerals now granted a percentage depletion allowance, and for the same reasons encouragement for prospecting and development should be extended to crushed stone producers. In addition, some of those minerals to which percentage depletion applies are in direct competition with crushed stone. This statement is in support of a request for a 15-percent percentage depletion allowance for producers of crushed stone. [Italics supplied.]

FOREWORD

This statement was prepared and is presented by the National Crushed Stone Association and the Agricultural Limestone Institute, a division thereof, which represent producers of a substantial majority of *all the crushed stone* commercially mined and quarried in the United States. It is offered for the following purposes:

1. To present a brief but clear picture of the *crushed-stone industry* and its importance in the general industrial field, the place it occupies in the category of natural-resource industries of the United States, and the similarity of its geological occurrence and methods of recovery to certain other natural-resource industries to which percentage depletion allowances have been granted. [Italics supplied.]

2. To point out the inequitable and unjust discrimination which now exists against the *crushed-stone industry* by reason of its present exclusion from the list of natural resources enjoying the benefits of percentage depletion. [Italics supplied.]

3. To request a remedy for this situation by amendment of the Internal Revenue Code to extend the percentage depletion allowance of 15 percent of gross income to the *crushed-stone industry.* [Italics supplied.]

The principle of percentage depletion has been before Congress for so long and the soundness and equity of this method of arriving at depletion allowances have received such a thorough and technical consideration that this statement will not attempt to cover the same ground again but will only briefly refer to the principle to show its applicability to *crushed-stone production.* (See appendix.) [Italics supplied.]

DESCRIPTION AND USES

Crushed stone includes igneous rocks such as *granite,* syenite, diorite, basalt, and other trap rocks; sedimentary rocks such as *limestone, dolomite,* and sandstone; and metamorphic rocks such as gneiss, schist, eclogite, and *marble.* [Italics supplied.]

Crushed stone is used for concrete aggregate and road metal, metallurgical stone (flux), agricultural and ground limestone, railroad ballast, alkali works,

riprap and jetty stone, refractory stone, stone sand, and for a wide variety of miscellaneous uses. [Italics supplied.]

[482] *Highway construction*

By far the largest single use of *crushed stone* is for highway construction. * * * [Italics supplied.]

Agricultural limestone

One of the important classifications of *crushed stone,* the use of which warrants special mention, is that of agricultural limestone, because of its effect on the health and economy of the Nation. * * * [Italics supplied.]

* * * * *

PRODUCTION AND VALUE

Crushed stone is substantially produced in over 30 of the 48 States, with the States producing the largest tonnages being California, Illinois, Indiana, Iowa, Kentucky, Michigan, Missouri, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia, and Wisconsin. [Italics supplied.]

The latest statistics available, compiled by the United States Bureau of Mines for the year 1948, show a total of 223,863,780 short tons produced in the United States, with a value of $280,960,452, *making the average value per ton $1.26. As can readily be seen, crushed stone sells at an extremely low price.* High transportation and operation costs, together with the low sales price, leave the producer only a relatively narrow profit margin. * * * [Italics supplied.]

* * * * *

MINING AND PROCESSING

[483]

The various types of stone in their natural occurrence and methods of recovery, in most respects, are similar to other minerals. They are found depos-

ited in different states of purity in beds or veins in the earth, and are recovered either by open pit or underground mining. * * *

* * * * *

WHY CRUSHED-STONE PRODUCERS SHOULD BE ALLOWED PERCENTAGE DEPLETION

* * * * *

The producers of numerous minerals now enjoy this simplified method of returning capital to the taxpayer (see appendix), including direct competitors of the *crushed-stone industry*. * * * [Italics supplied.]

DISCRIMINATION BETWEEN CRUSHED-STONE PRODUCERS AND OTHER MINERAL PRODUCERS

We heartily favor the percentage depletion method for other mining industries, but the *crushed-stone industry* fails to see any essential difference between the mining of crushed stone and certain nonmetallic minerals and is convinced that the discrimination between *crushed stone* and other nonmetallic minerals which have long had percentage depletion should be eliminated. [Italics supplied.]

* * * * *

[487] Mr. RAREY. The *crushed stone industry* requires the benefit of percentage depletion to remove the inequalities that now exist to its disadvantage. Materials such as rock asphalt for paving purposes, tar as a byproduct from coal, asphalt as a byproduct from oil, now benefit from percentage depletion, and all are competitive in the highway field with *crushed stone*. A similar inequality exists in many chemical and manufacturing processes where stone is competitive with other materials which now enjoy percentage depletion. [Italics supplied.]

* * * * *

It follows, therefore, that the *inequalities* that are said to now exist in the percentage depletion tax

structure *in favor of the big corporations can and should be removed by making percentage depletion* [488] *available to small business* as characterized by the members of the *crushed stone industry.* [Italics supplied.]

* * * * * *

Mr. JENKINS. Let me ask you this question. I see you are the president of the Marble Cliff Quarry Co. there in Columbus.

Mr. RAREY. That is right.

Mr. JENKINS. What do you take out of your quarries, is it lime or sandstone?

Mr. RAREY. Limestone.

Mr. JENKINS. Altogether limestone?

Mr. RAREY. Yes, sir.

Mr. JENKINS. And your principal product is sold as crushed lime?

Mr. RAREY. Our principal product is metallurgical stone for the production of pig iron and for the burning of lime which in turn is used in part by the steel industry. We produce a great deal of road stone and railroad ballast and a considerable amount of ground stone for agricultural uses, particularly in the southern and southeastern part of the State.

Mr. JENKINS. In other words, in the manufacture of iron, all of the iron furnaces must have lime.

Mr. RAREY. It takes about 800 pounds of stone to a ton of steel.

Mr. JENKINS. You supply that as they want it.

Mr. RAREY. Yes.

Mr. JENKINS. It must have a certain chemical quality?

Mr. RAREY. It must have a certain chemical analysis.

Mr. JENKINS. Up to a standard.

Mr. RAREY. Yes.

Mr. JENKINS. You say there are many people in the country engaged in this business?

[489] Mr. RAREY. Not that particular type of business. *I speak for the crushed stone industry generally.* It goes into highways and construction, but there are subdivisions. You will recall that Mr. Dickey of the Kelley Island Lime & Transport Co. and the professor from Lansing, Mr. Landes, I believe it was, spoke earlier and directed their remarks specifically to the stone that is burned or can be burned. [Italics supplied.]

Mr. JENKINS. I presume that the big iron and steel companies like Republic and United States Steel have their own mines, do they?

Mr. RAREY. Some of them do. United States Steel Corp. does; Republic not so extensively. They buy considerable of their fluxing stone. We supply the independent furnaces, such as the American Rolling Mill, Wheeling Steel & Iron, and Timken.

Mr. JENKINS. All of these little foundries, and anybody that melts iron, they have to have that.

Mr. RAREY. They have to have a chemical stone of a given chemical analysis.

Mr. SIMPSON. If the committee should see fit to grant this allowance to your industry, *you would not want it confined to the metallurgical stone, stone used for metallurgical purposes?* [Italics supplied.]

Mr. RAREY. *No; I speak for the entire stone industry today.* [Italics supplied.]

* * * * *

Statement of HORACE C. KRAUSE, President, Columbia Quarry Co., St. Louis, Mo.

Mr. KRAUSE. My name is Horace C. Krause, president of the Columbia Quarry Co. I am chairman of the percentage depletion committee for the National

Crushed Stone Association and Agricultural Limestone Institute.

Our company is operating three plants in Illinois and one in Missouri. Some of these plants are operated as open quarries, and some as underground mines. * * * Our products are used in the following industries: Construction, farming, aluminum, pig iron, gray iron, glass, copper, lead, feed, minerals, fertilizers, clay pigeons, rubber, coal, roofing, explosives, chemicals, and other uses.

Other *limestone and crushed stone producers* supply materials that go into these industries: Carbide, soda ash, paper, pharmaceuticals, carriers and extenders, in paint, putty, remedies, chalk, whiting, and so forth. [Italics supplied.]

* * * * *

[490] We, therefore, ask that the *crushed stone industry, including limestone and stone of all types,* be granted percentage depletion. [Italics supplied.]

* * * * *

Mr. JENKINS. Mr. Rarey, who testified a little while ago, asked to have consent to file his written statement with his other statement.

[The same statement was again presented by Mr. Krause in Senate Hearings in 1951. See the Revenue Act of 1951, Hearings before the Committee on Finance, United States Senate, 82d Cong., 1st Sess., on H.R. 4473 (Part 2) (1951), pp. 902-908.]

Senate Hearings, 1950

(Senate Hearings, Revenue Revisions of 1950)

[808] Statement in support of Percentage Depletion for Crushed-Stone Producers.

FOREWORD

This statement was prepared and is presented by the National Crushed Stone Association and the Agricultural Limestone Institute, a division thereof, which represent *producers of a substantial majority of all the crushed stone commercially mined and quarried in the United States.* * * * [Italics supplied.]

* * * * *

DESCRIPTION AND USES

Crushed stone includes igneous rocks such as *granite,* syenite, diorite, basalt, and other trap rocks; sedimentary rocks such as *limestone, dolomite, and sandstone;* and metamorphic rocks such as gneiss, schist, eclogite, and *marble.* [Italics supplied.]

Crushed stone is used for concrete aggregate and road metal, metallurgical stone (flux), agricultural and ground limestone, railroad ballast, alkali works, riprap and jetty stone, refractory stone, stone sand, and for a wide variety of miscellaneous uses. [Italics supplied.]

* * * * *

[809] PRODUCTION AND VALUE

* * * * *

The latest statistics available, compiled by the United States Bureau of Mines for the year 1948, show a total of 223,863,780 short tons produced in the United States with a value of $280,960,452, making the average value per ton $1.26. As can readily be seen, crushed stone sells at an extremely low price. High transportation and operation costs, together with the low sales price, leave the producer only a relatively narrow profit margin. * * *

* * * * *

WHY CRUSHED-STONE PRODUCERS SHOULD BE ALLOWED PERCENTAGE DEPLETION

* * * * *

The producers of numerous minerals now enjoy this simplified method of returning capital to the taxpayer (see appendix), including direct competitors of the *crushed-stone industry.* * * * [Italics supplied.]

* * * * *

[811] WHY THE RATE SHOULD BE 15 PERCENT

* * * * *

* * * The percentage depletion method with an allowance of 15 percent of gross income has proved satisfactory in the case of similarly situated industries, such as rock asphalt, rock phosphate, potash, and ball and sagger clay, and has been easily administered at a minimum of cost to both the Government and the taxpayer. *Crushed-stone producers* believe that such an allowance would be eminently fair and as effective in their own case and repectfully request that your committee recommend to Congress an amendment to section 114 of the Internal Revenue Code which will extend the percentage depletion allowance of 15 percent of gross income to the producers of crushed stone. [Italics supplied.]

Respectfully submitted.

NATIONAL CRUSHED STONE ASSOCIATION,
By J. R. BOYD,
Administrative Director.

AGRICULTURAL LIMESTONE INSTITUTE,
By HENRY A. HUSCHKE,
Managing Director.

(House Hearings, Revenue Revision of 1951)

[1631] Statements of RUSSELL RAREY, President, Marble Cliff Quarries Co., Columbus, Ohio, and HORACE C. KRAUSE, President, Columbia Quarry Co., St. Louis, Mo.

Mr. RAREY. Mr. Chairman, my name is Russell Rarey, of Columbus, Ohio. I am president of the Marble Cliff Quarries Co.

Our company operates a limestone open quarry near Columbus, Ohio, and a limestone underground mine in western Ohio. The character of the stone is such that it is used for chemical and metallurgical purposes, for burned lime, for agricultural use, for railroad ballast, for highway construction and maintenance, and for miscellaneous building purposes including airport runways, and so forth.

I am a member of the executive committee of the National Crushed Stone Association and also a member of its committee on percentage depletion. In this latter capacity, it was my privilege last year, along with others, to appear before your committee and submit a statement in support of percentage depletion allowance for the crushed stone and agricultural limestone industries.

[1632] Later your committee recommended that our industries be granted a percentage depletion allowance, and I assure you that the favorable recommendation of your committee was greatly appreciated by the members of our industry. Nevertheless, due to subsequent developments, those recommendations were not incorporated into law; we thereby continue without a percentage depletion allowance which is so badly needed.

In cooperation with Mr. Horace Krause, represent-

ing the Agricultural Limestone Institute, I wish to present for your consideration and for the record a formal statement on behalf of the National Crushed Stone Association and the Agricultural Limestone Institute.

This statement submits that the same reasons that won your favorable recommendation last year are as of this moment more impelling than ever before. May I commend the statement to you for your consideration. May I, also, with your permission, comment briefly as to these further impelling reasons.

Failure to grant to the *crushed stone industry* a percentage depletion lies in the difficulty of finding replacement areas for our exhausted stone deposits. * * * [Italics supplied.]

* * * * *

[1633] Your committee was correct in its judgment of 1 year ago in recommending a percentage depletion allowance for the *crushed stone industry,* and there is now even greater reason why that judgment by your committee should be reaffirmed and we respectfully request your favorable consideration to that end. [Italics supplied.]

(The formal statement of the National Crushed Stone Association and Agricultural Limestone Association follows:)

Statement in Support of the Action of the Ways and Means Committee and the House in 1950 Approving Percentage Depletion for Crushed Stone.

* * * * *

Producers of crushed stone are fully aware that at first glance the addition of crushed stone to the depletion list appears inconsistent with the present need for revenue. However, in the first place, the revenue involved in this item is relatively inconsequential and, secondly, the need for revenue, however pressing, is

not a valid basis for an inequitable distribution of the tax burden so as to discriminate between *crushed stone* and competing nonmetallic minerals. [Italics supplied.]

* * * * * * *

[1634] In order to avoid repetition of evidence heretofore furnished the committee, we refer to the testimony on this subject given last year, which contains a fully documented discussion of the position of the *crushed-stone industry* in this matter (hearings, vol. 1, Feb. 9, 1950, pp. 480–491). [Italics supplied.]

* * * * * * *

We do however, hold strongly to our previous position that the allowance should be 15 percent as now accorded rock asphalt, ball and sagger clay, china clay, bentonite, vermiculite, iron ore, lead, zinc, and barite, all of which are directly competitive with crushed stone and agricultural limestone; and as accorded potash, phosphate rock, and trona, which are indirectly competitive. * * *

The reasons which justified the committee and the House in voting last year to grant a percentage-depletion allowance to *crushed stone* are even more persuasive at this time in view of the increased tax burden, a fair share of which the *crushed-stone industry* will gladly assume in the interest of the defense program. [Italics supplied.]

NATIONAL CRUSHED STONE ASSOCIATION
AND AGRICULTURAL LIMESTONE INSTITUTE,
RUSSELL HAREY,
HORACE C. KRAUSE,
Members of Percentage Depletion Committee.

MARCH 5, 1951.

* * * * * *

[1635] Mr. KRAUSE. My name is Horace C. Krause, president of the Columbia Quarry Co., St. Louis, Mo. I am chairman of the Percentage Depletion Committee for the National Crushed Stone Association and the Agricultural Limestone Institute.

Our company is operating three plants in Illinois and one in Missouri. Some of these plants are operated as open quarries and some as underground mines. These plants produce riprap, derrick stone, agricultural limestone, ballast, fluxing stone, chemical limestone, crushed stone, and various types of fillers.

* * *

* * * * * *

[1636] Mr. SIMPSON. *Are you referring to limestone used in agriculture, and also to crushed limestone used in construction work?* [Italics supplied.]

Mr. KRAUSE. *All purposes.* [Italics supplied.]

* * * * * *

Mr. SIMPSON. What you object to is what appears to be a type of advantage to your competitors?

Mr. KRAUSE. That is correct.

* * * * * *

Senate Hearings, 1951

(Senate Hearings, the Revenue Act of 1951)

[891] Statement of RUSSELL RAREY, President, Marble Cliff Quarries Co.

* * * * * *

I wish to submit for the record this formal statement on behalf of the National Crushed Stone Association and Agricultural Limestone Institute in support of a percentage depletion allowance for the *crushed stone industry,* and I will not impose upon the time of the committee to read the statement, copies of

which, I understand, have been placed before you. [Italics supplied.]

The CHAIRMAN. You may put it into the record.

Mr. RAREY. Thank you, sir.

I do, however, desire to make the following observations in my own behalf in support of the formal statement.

My company operates a limestone open quarry or mine near Columbus, Ohio, and a limestone underground mine in western Ohio. The character of the stone is such that it is of value for chemical and metallurgical purposes, for burned lime, and for agricultural use, for railroad ballast, for highway construction and maintenance and for miscellaneous construction work, including airport runways, et cetera.

* * * * *

[892]

* * * * *

At this point may I suggest that a continuation of the *crushed stone business* is essential. Without suitable aggregates, there can be no modern construction; without agricultural limestone the productive capacity of our farm land would be reduced and our food supply lessened, and without metallurgical stone and lime, there can be no steel. [Italics supplied.]

* * * * *

[893]

* * * * *

Mr. RAREY. Well, with us we are in the Devonian stone in the Columbia and Delaware formations, which are limestone, with a high percentage of calcium and relatively low percentage of magnesium.

Roughly divided into general stratas, the upper ledges contain silica that makes it unsuitable for

chemical purposes, yet it is desirable for construction purposes; and the lower ledges are the chemical ledges that go into steel and lime, and the general chemical manufacturing processes.

Senator KERR. And which geological age, generally, provides the more abundant——

Mr. RAREY. I would not at this time be able to answer that.

Senator KERR. Opportunity.

Mr. RAREY. I would not know which geological formation or age—the common designation of those stones, such as granite or trap rock, as differentiated from limestone, each occur in different sections of the country, and *are each applicable to their own particular uses, although there is a common use, or there is a use that is common to all of them and that is in the construction field.* [Italics supplied.]

* * * * *

(The prepared statement referred to follows:)

[894] Statement in Support of House Bill Provision to include Crushed Stone among Competing Minerals allowed percentage depletion.

In 1950, and again this year, the House has voted to eliminate an unjust discrimination against *crushed stone* and has included it among nonmetallic minerals entitled to percentage depletion. [Italics supplied.]

Last year the Senate Committee did not deny that *crushed stone* is entitled to percentage depletion, but decided "to postpone action on these proposals until your committee can carry out a more careful analysis of the problems involved." [Italics supplied.]

We urge this structural change in the act as a matter of equity. In fact, the House bill offers only partial relief since it provides a 5 percent depletion allowance for crushed stone, whereas certain compet-

ing minerals are granted 15 percent under existing law.

* * * * *

The competitive relationship between rock asphalt and *crushed stone* is such that failure to grant the same percentage depletion allowance of 15 percent to the *crushed stone industry* as is now enjoyed by the rock asphalt industry would be to continue an unjust discrimination. [Italics supplied.]

* * * * *

[895] For reasons set forth above we respectfully urge the committee to adhere to the position that it took last year of granting a percentage depletion allowance to *crushed stone* to remedy the discriminatory exclusion of *crushed stone* from the competitive minerals which are permitted depletion allowances. [Italics supplied.]

We do, however, hold strongly to our previous position that the allowance should be 15 percent as now accorded rock asphalt, ball and sagger clay, china clay, bentonite, vermiculite, iron ore, lead, zinc, and barite, all of which are directly competitive with crushed stone and agricultural limestone; and as accorded potash, phosphate rock, and trona, which are indirectly competitive. * * *

* * * * *

House Hearings, 1953

(House Hearings, General Revenue Revision (1953))

[2100] Statement in Support of Percentage Depletion for Crushed Stone Producers by National Crushed Stone Association, Washington, D.C.

Mr. Chairman and gentlemen, my name is Russell Rarey and I am president of the Marble Cliff Quarries Co. at Columbus, Ohio, and I am chairman of the percentage depletion committee of the National

Crushed Stone Association. This statement is presented today on behalf of that association.

The National Crushed Stone Association reaffirms its belief in the long-recognized congressional policy that allowances for the depletion of natural resources should be determined on the basis of a percentage of gross income, and in the application of this policy to the stone industry.

INEQUITIES CREATED BY MULTIPLE RATES FOR THE STONE INDUSTRY

One of the basic reasons for percentage depletion was that the previous depletion system was "* * * neither simple in its application nor equitable in its results. The * * * system * * * [was] not only enequitable between taxpayers in the same branch of the mining and quarrying industry, but the distribution between the different branches * * * [was] unjust." Staff Report on Depletion, Joint Committee on Internal Revenue Taxation, 1929, p. 22).

(a) *Discrimination between the stone industry and its competitors.*—When this association appeared before your committee in 1951 we adhered to our prior request for a uniform rate as follows:

* * * * *

We now reaffirm this position and recommend adoption of a 15-percent uniform rate for the stone industry.

(b) *Discrimination between members of the stone industry.*—The Revenue Act [of 1932] which followed the joint committee report of 1929, cited above, fixed a uniform percentage depletion rate of 15 percent for all metal mines. The revenue bill of 1949, as it passed the Senate, added stone to the percentage depletion provision at 15 percent for all quarries.

These Senate-approved additions, including the flat 15 percent rate for all stone deposits, were postponed when the bill went to conference.

As the Revenue Act of 1951 was finally enacted it contained three different rates for stone: 15 percent for limestone, chemical grade and metallurgical grade; 10 percent for calcium carbonates, magnesium carbonates, and dolomite; and 5 percent for stone. *Stone in all of these categories in many instances is quarried by the same company, and in some instances from the same quarry.* [Italics supplied.]

It is apparent, therefore, that *with three rates of percentage depletion* applied *to the product of our industry* inequalities of tax treatment exist as between different and competing individual members of our industry. Establishment of a uniform rate of 15 percent for all of the products of our industry would not only cure this defect but also resolve numerous administrative problems these inequalities create. [Italics supplied.]

LIMESTONE: ONLY CHEMICAL AND METALLURGICAL GRADE

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[332] Statement of Ralph L. Dickey, President, the Kelley Island Lime & Transport Co., Cleveland, Ohio.

Mr. DICKEY. My name is Ralph L. Dickey. I am president of the Kelley Island Lime & Transport Co. of Cleveland, Ohio. I am appearing as a representative of a committee of the National Lime Association requesting a 15-percent depletion allowance for limestone when calcined or when used by the metal-

lurgical or chemical industry. A [333] bill, H.R. 2537, has been introduced and is pending before this committee which would accomplish this result. Our company operates three quarries in Ohio, two of which have adjacent calcining lime plants, and one lime plant at Buffalo, N.Y.

The types of high quality limestone used for metallurgical or chemical purposes or for producing calcined products are found in relatively few areas and constitute an insignificant proportion of all limestone deposits. This bill provides depletion allowance for only such high grade limestone that is produced for the uses described.

Under present highly competitive conditions, fuel and labor costs, and greatly increased plant investments required, any limestone deposit which is used for the calcination or burning of lime must be of high chemical purity. The term "limestone when calcined" includes all forms of burnt lime, *including burnt dolomite.* [Italics supplied.]

* * * * *

[334] As to possible difficulties in administration, it is a simple matter to classify the use of limestone. In fact, such classification has been and is being done regularly and used by United States Bureau of Mines in compiling industry information which is published annually. *Limestone is a bulk commodity which almost exclusively is shipped in carload quantities direct from the point of production to the point of use.* Our invoices and books show definitely the type of user to whom shipments are made. * * * [Italics supplied.]

* * * * *

[335] Mr. LYNCH. Does your proposal contemplate percentage depletion allowance for limestone used in agriculture or roadbuilding or anything of that kind?

Mr. DICKEY. No, sir; it does not. While our com-

pany and our industry makes substantial sales in those fields, it is not necessary to use the grade of limestone required for the chemical and metallurgical use in those uses and we did not feel justified in asking for percentage depletion on that type of stone.

Mr. LYNCH. You are only asking for percentage depletion insofar as limestone is used for metallurgical purposes, is that true?

Mr. DICKEY. That is correct.

* * * * *

Statement of Prof. KENNETH K. LANDES, Chairman, Department of Geology, University of Michigan, Ann Arbor, Mich.

* * * * *

One year ago I prepared for the National Lime Association a survey of domestic high-grade limestone deposits. This survey has been published by that association and distributed to your committee.

* * * * *

[336]

* * * * *

High quality—metallurgical grade—limestone is just as essential to the making of steel as iron ore; it is also necessary for the burning of lime and for the manufacture of many chemicals. Limestone, the rock, is common and abundant in the United States, but metallurgical stone constitutes only a very small part of the total volume of limestone rock. It is a valuable, essential, and exhaustible mineral resource.

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[338]

* * * * *

Mr. WOODRUFF. Mr. Chairman, the doctor has a fund of information in this document he has placed before every member of this committee, and I ask

unanimous consent that it may be made a part of the record.

The CHAIRMAN. Without objection, it is so ordered.

Thank you very much, Doctor.

Professor LANDES. Thank you.

(The document referred to follows:)

METALLURGICAL LIMESTONE RESERVES IN THE UNITED STATES

(By Kenneth K. Landes, Ann Arbor, Mich.)

SUMMARY AND CONCLUSIONS

High-quality (metallurgical grade) limestone is just as essential to the making of steel as iron ore; it is also necessary for the burning of lime and for the manufacture of many chemicals. Limestone, the rock, is common and abundant in the United States, but metallurgical stone constitutes only a very small part of the total volume of limestone rock. It is a valuable, essential, and exhaustible mineral resource.

* * * * *

[339]

* * * * *

KENNETH K. LANDES.

FEBRUARY 5, 1949.

INTRODUCTION

Limestones, if no limitation as to quality is set, are found very generally in tremendous quantities in most parts of the United States. However, limestones that are of suitable quality and are economically available are a very small proportion of the total of all limestones and are found only in a few areas.

In this report, "limestone" will be used as in industry for *both limestone and dolomite*, except where

the latter is specifically mentioned. Included within the broad heading "Metallurgical stone" are not only the fluxes used in blast furnace and open-hearth operations but also the purer grades of limestone needed for furnace linings, lime burning, and chemical manufacture. [Italics supplied.]

Limestones that are satisfactory for metallurgical or chemical uses as stone or satisfactory for *raw material* for the production of calcined products may be classified in four grades, as follows: [Italics supplied.]

* * * * *

These specifications are arbitrarily made to provide a means of identifying various classes of limestone, since there are no generally agreed-upon standards. Silica, alumina, and sulfur are impurities. Magnesia is an active basic agent, but limestones with varying proportions of magnesia may have different uses.

By far the greater part of the limestone quarried or mined in the United States has more than the maximum percentage of impurities listed above. This stone is used for concrete aggregate, road metal, railroad ballast, agricultural limestone, cement manufacture, and other purposes where chemical purity is not essential.

Descriptions of uses of metallurgical stone

Over half of the total volume of stone here classified as "metallurgical" consumed annually is used as blast-furnace flux. The blast furnace is the fundamental unit in the conversion of iron ore to pig iron. * * *

[340]

* * * * *

Metallurgical stone can only be used in lump form. The fines produced during mining and processing must be discarded or marketed elsewhere. Furthermore, pulverant types of limestone such as chalk and marl cannot be used for metallurgical purposes, regardless of purity. [Italics supplied.]

* * * * *

The burning of limestone to produce limes consumes 25 percent of the stone here classified as "metallurgical" each year. One of the most important uses of calcined limestone (lime) is as a flux in the production of steel in the open hearth. Chemical stone, used in making such products as soda ash and calcium carbide, and in the refining of beet sugar, must be of A–1 grade in most instances, although B–1 stone is used in quantity for some purposes. Quality plasters can be made only from A–1 or B–1 stone.

* * * * *

The total metallurgical stone production is roughly one-third of the annual domestic *crushed limestone* produced (*the amount of limestone mined for building stone is relatively insignificant*). The remaining two-thirds of the *crushed stone* has many uses, especially in concrete and road metal, and as cement stone. For these purposes lower grade stone, which does have large reserves, is adequate; in fact, the more silica and alumina in cement stone the less shale has to be added before burning. The emphasis for stone used in concrete aggregate and road metal is on physical character rather than chemical composition. [Italics supplied.]

* * * * *

(House Hearings, Revenue Revision of 1951)

[1553] Statement of RALPH L. DICKEY, President, The Kelley Island Lime & Transport Co., Cleveland, Ohio.

* * * * *

Mr. DICKEY. * * *

I am a representative of a committee of the National Lime Association and am requesting that a percentage depletion allowance be provided [1554] for metallurgical and chemical grade limestone at a rate of 15 percent. * * *

Limestone is essential to and used directly in the production of pig iron, steel, caustic soda, soda ash, glass, and sugar, to name only a few important uses.

Lime, which is produced by calcining or burning chemical and metallurgical grade limestone is used by almost every type of industry as well as for the treatment of water, sewage, and trade wastes. Lime is essential in the production of steel, aluminum, magnesium, calcium carbide, and certain explosives from Government ordnance plants. It is also on the atomic energy program, although I do not know how.

* * * * *

[1555] Last year in the report of this committee, you stated, among other things, that, and I quote:

> The testimony before your committee revealed that in a number of cases nonmetallic minerals which are not enumerated in existing law are competitive with the minerals receiving percentage depletion or have just as good a claim for such treatment as the enumerated minerals.

In view of the fact that the Congress has recognized the principle of percentage depletion allowances, has

provided such allowances for iron ore and other natural resources certainly no more critical in the economy than high purity limestone, we respectfully request that a percentage depletion allowance be granted to metallurgical and chemical grade limestone at the rate of 15 percent.

(The statement entitled "Metallurgical Limestone Reserves in the United States," by Kenneth K. Landes, referred to, is as follows:)

* * * * *

[This is the same as that submitted during House Hearings in 1950, set forth above at pages 384–386.]

* * * * *

[1566] Statement of PHILIP L. CORSON, G. & W. H. Corson, Inc., Plymouth Meeting, Pa.

Mr. CORSON. My name is Philip L. Corson, and I am president of G. & W. H. Corson, Inc., of Plymouth Meeting, Pa.

* * * * *

The CHAIRMAN. All right, go ahead.

Mr. CORSON. We manufacture lime, refractories, and limestone products from our quarry located near Philadelphia, Pa.

* * * * *

For every ton of steel manufactured, nearly one-half ton of limestone is required—and I repeat that, for every ton of steel manufactured, nearly one-half ton of limestone is required—either in the form of raw limestone, burned limestone, or dead burned dolomitic limestone. * * *

* * * * *

[1568] Mr. JENKINS. Mr. Dickey, I should like to ask you a few questions. How much by way of a de-

pletion allowance did this committee recommend last year?

Mr. DICKEY. 15 percent.

Mr. JENKINS. And we limited that to metallurgical and chemical grades of limestone; did we not?

Mr. DICKEY. That is correct.

Mr. JENKINS. As I remember your statement, I believe you said that common limestone is available and can be found in nearly all parts of the country?

Mr. DICKEY. Ordinary limestone can; that is correct.

Mr. JENKINS. But this type known as metallurgical and chemical limestone is not the ordinary limestone?

Mr. DICKEY. It is far from it. It forms a very small percentage of the total limestone known.

* * * * *

[1569] Mr. JENKINS. I thank you for your answer, for I wanted to bring out the fact that the kind of lime you are talking about is not the common limestone that is present in all parts of the country. I notice that Dr. Landes in his report states that metallurgical- and chemical-grade limestone is produced in four counties in Ohio.

Does the cement industry require this metallurgical and chemical grade of limestone?

Mr. DICKEY. No, sir; it does not. They do not care how much silica or alumina there is in the limestone. Jones & Laughlin Steel Co. bought a large area on the Ohio River, figuring that they would have to go down some 600 or 700 feet to the limestone. But they did not find the operation feasible, and so they sold the property.

Mr. JENKINS. What is the grade of limestone that is used in farming, this limestone that they grind up and use?

Mr. DICKEY. It is the more common type of limestone, and the amount of silica in it doesn't make any difference. They can still use it.

Mr. JENKINS. Is this lime that you are talking about used as fertilizer?

Mr. DICKEY. Only as a byproduct.

Mr. JENKINS. That is because it is too expensive?

Mr. DICKEY. That and the fact that it is too important for other uses.

Mr. JENKINS. Now, in your prepared statement you say that the steel industry depends upon your product in the manufacture of steel?

Mr. DICKEY. Absolutely.

Mr. JENKINS. Can they use the farmer's type of limestone?

Mr. DICKEY. No. It will affect their economy and production, and they can only go so far with it. They really can't use it at all.

Mr. JENKINS. It chokes up their furnaces?

Mr. DICKEY. The purpose of the limestone in the case of pig iron is to remove the silica from the coke, and the more silica you have in the limestone the less effective it is.

Mr. JENKINS. Then limestone is essential in the production of steel?

Mr. DICKEY. Absolutely.

* * * * * *

Senate Hearings, 1951

(Senate Hearings, Revenue Act of 1951)

[872] Statement of RALPH L. DICKEY, President, Kelley Island Lime & Transport Co.

* * * * * *

[873] I am a representative of a committee of the National Lime Association and am requesting that a percentage depletion allowance be provided for

metallurgical and chemical grade limestone at a rate of 15 percent, as now provided in the bill before you, H.R. 4473. * * *

[874]

* * * * *

(The report submitted by Mr. Dickey is as follows:)

[875] METALLURGICAL LIMESTONE RESERVES IN THE UNITED STATES

SUMMARY AND CONCLUSIONS

* * * * *

Limestones that are satisfactory for metallurgical or chemical uses as stone or satisfactory for *raw material* for the production of calcined products may be classified in four grades as follows: [Italics supplied.]

* * * * *

By far the greater part of the limestone quarried or mined in the United States has more than the maximum percentage of impurities listed above. This stone is used for concrete aggregate, road metal, railroad ballast, agricultural limestone, cement manufacture, and other purposes where chemical purity is not essential.

[876]

* * * * *

Metallurgical stone can only be used in lump form. The fines produced during mining and processing must be discarded or marketed elsewhere. Furthermore, pulverent types of limestone such as chalk and marl cannot be used for metallurgical purposes regardless of purity.

* * * * *

The burning of limestone to produce lime consumes 25 percent of the stone here classified as "metallurgical" each year. * * *

* * * * *

The total metallurgical stone production is roughly one-third of the annual domestic *crushed limestone* produced (*the amount of limestone mined for building stone is relatively insignificant*). The remaining two-thirds of the *crushed stone* has many uses, especially in concrete and road metal, and as cement stone. For [877] these purposes lower grade stone, which does have large reserves, is adequate; in fact, the more silica and alumina in cement stone the less shale has to be added before burning. The emphasis for stone used in concrete aggregate and road metal is on physical character rather than chemical composition. [Italics supplied.]

* * * * *

[878] * * * Although a premium grade stone may be sold for low quality uses, an inferior stone cannot be marketed for metallurgical purposes, especially in recent years.

* * * * *

House Hearings, 1953

(House Hearings, General Revenue Revision (1953))

[2091] Statement of E. EIKEL, President, Servtex Materials Co., in Support of Percentage Depletion for Crushed-Stone Producers.

My name is E. Eikel and I am president of Servtex Materials Co., of New Braunfels, Tex. I am also a regional vice president of the National Crushed Stone Association and a member of the board of directors of that association. This statement is presented on behalf of Servtex Materials Co.

First, I want to state that I concur fully in the statement of Mr. Russell Rarey made to the committee on behalf of the National Crushed Stone Association on August 12, 1953.

In addition, I want to identify for the committee some specific problems that Servtex Materials Co. faces under the new percentage depletion regulations of the Treasury Department, as amended.

We produce and market principally *crushed stone* and asphaltic concrete. *Both are produced from limestone of chemical and metallurgical grade,* the latter being a mixture of crushed and screened limestone, water, and liquid asphalt. These materials are in daily competition with rock asphalt and dolomite, both of which enjoy a depletion rate higher than stone. Rates for rock asphalt and dolomite were fixed by Congress without regard to end use. [Italics supplied.]

* * * * *

[2092]

* * * * *

The limestone which we, Servtex Materials Co., New Braunfels, Tex., quarry is of chemical and metallurgical grade. The limestone meets the specifications for chemical and metallurgical grade required by the chemical and metallurgical industries we serve. * * * This chemical and metallurgical grade limestone also meets the requirements necessary for highway and road construction to which a substantial portion of our quarry output is devoted. *Limestone supplied for highway and road construction and that furnished the chemical and metallurgical industries is all obtained from the identical source or deposit. All of the limestone in the deposit from which we quarry is*

of chemical and metallurgical grade, regardless of end use. [Italics supplied.]

* * * * *

MAGNESITE

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1953

(House Hearings, General Revenue Revision (1953))

[2059]

* * * * *

Statement of A. BRENT WILSON, Assistant to President and Director of Northwest Magnesite Corp., Pittsburgh, Pa.

Mr. WILSON. My name is A. Brent Wilson. I am assistant to the president and a director of Northwest Magnesite Corp., Pittsburgh, Pa. This statement is submitted to the Committee on Ways and Means of the House of Representatives, on behalf of my company, which mines magnesite at Chewelah, Wash.

* * * * *

[2060]

* * * * *

THE MAGNESITE INDUSTRY

* * * * *

Magnesite is an extremely hard rock, blocky in nature and crystalline in appearance. The deposits occur in lens-shaped bodies, with no continuity between the deposits. Natural magnesite contains small quantities of silica, lime, alumina, and iron oxide as impurities.

The various steps in the *mining operations,* all performed at the mine, consist of stripping, open-cut

mining, *crushing, concentration, and burning to drive off the carbon dioxide and convert the crude material into a marketable product.* The only product shipped from our Chewelah mine is magnesium oxide in granular form, known commercially as dead-burned magnesite. It is principally used as a raw material for the manufacture of basic refractory brick and to form hearths of furnaces, especially open-hearth steel furnaces. [Italics supplied.]

* * * * *

MARBLE

(See "LIMESTONE: ALL GRADES • • • PLUS OTHER STONES • • •", INCLUDING • • • MARBLE • • •", *supra,* pp. 363–381.)

OYSTER SHELLS

(See "SHELLS", *infra,* pp. 418–423.)

PERLITE

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[436] Statement of WHARTON CLAY, Secretary-Treasurer, Perlite Institute, New York, N.Y.

* * * * *

Mr. CLAY. This is a very young industry; it is not more than 4 years old. * * * Perlite is a volcanic rock which, when heated to a suitable point in its softening range, expands, to make a lightweight aggregate. It is used to improve and lighten the weight of plaster and concrete. It is mined in seven Western States, and is processed in 21 States, including Massachusetts, New York, North Carolina, Michigan, California, and many other States in-between.

In my presentation which has been passed to you, which I request that you put in in full in the record, I have cited several national authorities.

* * * * *

(The statement referred to follows:)

[437]

Statement of Mr. WHARTON CLAY, Secretary-Treasurer of the Perlite Institute.

* * * * *

Perlite is the most recently recognized of the lightweight aggregates, and *competes directly in markets throughout the United States with vermiculite,* which presently enjoys the benefits of percentage depletion. [Italics supplied.]

* * * * *

Perlite is a volcanic rock, which when heated quickly to a suitable point in its softening range, expands to form a lightweight, noncombustible, glass-like material of cellular structure.

It is used to improve and lighten the weight of plaster and concrete. Improvements consist in the greater insulation value of the product and greater fire protection. Perlite competes in these characteristics directly with vermiculite and has achieved the same recognition in building codes as a fire protection medium that vermiculite has enjoyed for a number of years. [Italics supplied.]

* * * * *

House Hearings, 1951

(House Hearings, Revenue Revision of 1951)

[1650] Statement submitted by Mr. WHARTON CLAY, Secretary-Treasurer of Perlite Institute.

* * * * *

I wish to avoid a repetition of the detailed instances of such competition which have previously

been presented to the Ways and Means Committee in the hearings in connection with the 1949 and 1950 Revenue Revisions. I list below the additional *adaptations of perlite* which have come to my attention since my last testimony before the Ways and Means Committee. [Italics supplied.]

* * * * *

PHOSPHATE ROCK

(Percentage depletion first allowed beginning with 1947)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[380] Statement of KENNETH B. RAY, Counsel for Food Machinery & Chemical Corp., and also Representing Phosphate Rock Industry Group.

* * * * *

[382] In 1947 the benefits of percentage depletion were also extended to phosphate deposits. This turned out to be a particularly wise piece of legislation since the Government for many years had been endeavoring to secure widespread development of the phosphate deposits of southeastern Idaho. Following the addition of phosphates to the statute this company has expended over $10,000,000 in an electric furnace project to utilize the Idaho phosphate deposits. The economics of this development are based on *percentage depletion for the basic raw material, phosphate rock.* * * * [Italics supplied.]

* * * * *

House Hearings, 1951

(House Hearings, Revenue Revision of 1951)

[1637] Statement of KENNETH B. RAY, New York, N.Y., Counsel for Food Machinery and Chemical Corp., New York, N.Y.

Mr. RAY. Mr. Chairman, and gentlemen of the committee, my name is Kenneth B. Ray. I am appearing on behalf of a large segment of the phosphate rock industry, many of whose representatives are here today. I am also counsel for Food Machinery & Chemical Corp. which is engaged not only in the development of phosphate deposits in the West but is also mining trona in southwestern Wyoming.

* * * * *

[1638] NONMETALLIC MINERALS ESSENTIAL TO AGRICULTURAL PRODUCTION

Ninety percent of the 9 to 10 million tons of *phosphate rock* mined annually in the United States is *for use by farmers.* A reduction in the percentage depletion rate would almost certainly result in an increased selling price of *fertilizer sold to farmers.* The same statement applies to potash, about which I understand its representatives will testify. * * * [Italics supplied.]

* * * * *

Senate Hearings, 1954

(Senate Hearings, Internal Revenue Code of 1954)

[1334]

* * * * *

Statement of JAMES M. GILLET, Victor Chemical Works, Chicago, Ill.

Mr. GILLET. My name is James M. Gillet. I am assistant to the president of Victor Chemical Works, Chicago, Ill.

Victor Chemical Works, Mr. Chairman, is a chemical manufacturing firm that has plants in Montana, California, Illinois, Tennessee, Florida, and Pennsylvania. Most of our operations are connected with the *production of phosphates, starting with phosphate rock and continuing through to the production of*

some 150 chemicals that are used in practically every industry in the country. [Italics supplied.]

I appear before you in connection with a request to clarify section 613 of the code. * * *

[1335]

* * * * *

(The statement referred to follows:)

* * * * *

BRIEF OF VICTOR CHEMICAL WORKS

It is respectfully requested that section 613(c)(4)(E) of the proposed Internal Revenue Code of 1954 be amended as follows: Subsection (4)(E), after the words "burning of magnesite", add the words "and the *sintering* and *nodulizing* of phosphate rock". [Italics supplied.]

The sole purpose of the amendment is to clarify the meaning of the term "ordinary treatment process" as applied to phosphate rock in determining percentage depletion, so that the *miner* of phosphate rock may have a definite basis for determining his proper tax. [Italics supplied.]

* * * * *

[1337]

* * * * *

Mr. GILLET. * * *

The matter that I am referring to principally is the sintering of phosphate rock. * * * In order *to use this rock* in the production of phosphorus *it is necessary that it be in lump form.* The powdered, *low-grade* phosphate rocks, *unless they are made into lump form,* will not function in the furnace. [Italics supplied.]

Originally most of the phosphorus was produced from high-grade rock which was mined as pebbles or as plate in Tennessee, but since the growth of the

phosphate industry the supply of the lump rock is not enough for the industry.

It has been necessary for us to go to the use of low-grade rocks, which, incidentally, have no other use at all, except in the production of phosphorus and *to treat those rocks by sintering, in order to make big particles out of little ones.* [Italics supplied.]

* * * * * *

The income-tax returns are being filed now on the basis that sintering is an ordinary treatment process. * * *

The CHAIRMAN. Is it a common practice to sinter that rock, by other companies?

Mr. GILLET. It is, yes sir.

The CHAIRMAN. It is a general commercial practice?

Mr. GILLET. Those who make phosphorus, yes sir.

We would request, then, that subsection E—that is the last item in section 613—be amended by addition of the words "by the sintering and nodulizing of phosphate rock."

Some people say they are sintered and others say nodulized, but it is the same thing.

The CHAIRMAN. What is the sintering process?

Mr. GILLET. As we apply it, it consists of putting the powdered rock into a kiln, a rotary kiln where it is heated by a gas flame from natural gas, or by-product gas, or powdered coal. As it passes down through the kiln it warms up and gradually gets sticky. When it reaches the bottom of the kiln it is hot enough for these small particles to stick together. Those are discharged onto a moving grate where they are treated with a blast of air to cool them and they are then ready to put on the stockpile for use as a raw material in the production of phosphorus. There

is no chemical change involved and it is merely a physical operation.

* * * * *

POTASH

(Percentage depletion first allowed beginning with 1944)

Senate Hearings, 1943

(Senate Hearings, Revenue Act of 1943)

[363] Statement of F. O. DAVIS, Treasurer, Potash Co. of America.

* * * * *

[366] (The memorandum submitted is as follows:)

MEMORANDUM RE PERCENTAGE DEPLETION FOR POTASH

* * * * *

[369] IV. Income "from the property."

* * * * *

In the case of the leading brine producer, the mineral property consists of a nonreplenishing subterranean lake of heavy brine containing the potash in solution. The brine is pumped from the lake by means of drilled wells, and the potash is extracted from the brine at the lake site by means of unique *evaporation and crystallization processes* developed by the company for that purpose. The brine recovered from the company's potash deposits also contains varying amounts of borax, soda ash, and salt cake, and small quantities of lithium phosphate and bromine. * * * [Italics supplied.]

* * * * *

The evaporation and crystallization processes are elaborate in nature. Brine is pumped continuously through a series of processes which constantly require

delicate adjustments of temperature, pressure, etc., and chemical analyses of the liquors and products. The separation of the chemical constituents hinges on their differing limits of solubility at different temperatures and under varying pressures.

A characteristic feature is the evaporation of the liquor at high temperatures (except for which the liquor would be supersaturated) followed by quick cooling to a point at which a particular salt will be precipitated in solid form, while other constituents remain in solution. At one stage of the general process, soda ash, and salt cake are partially segregated, and at another stage, but while the liquor still contains about half the potash, borax is removed. Having gone through the process, the liquor is then repeatedly turned back along with the incoming fresh brine from the lake deposit and goes through the whole cycle again and again for further removal of the potash and other products.

* * * * *

[370] Respectfully submitted.

AMERICAN POTASH & CHEMICAL CORPORATION
INTERNATIONAL MINERALS & CHEMICAL CORPORATION
POTASH CO. OF AMERICA
UNITED STATES POTASH CO.

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[383] Statement of FRED O. DAVIS, Vice President and Treasurer, Potash Co. of America, Carlsbad, N. Mex.

* * * * *

[386] Mr. LYNCH. Mr. Davis, is it not so that the United States Court of Tax Appeals found as a fact that the discovery value of potash was 85 cents?

Mr. DAVIS. Eighty-five cents per ton was the figure granted under the discovery depletion case of United States Potash Co.

Mr. LYNCH. Did not the Bureau afterward set it on the basis of 82½ cents per ton?

Mr. DAVIS. I believe 85 cents was the final figure.

Mr. LYNCH. Eighty-five.

Mr. DAVIS. Yes, sir.

Mr. LYNCH. What is the price of potash f.o.b. mines?

Mr. DAVIS. The crude product is worth about $4.50 per ton of ore. The refined product, which takes 2½ tons to produce, is about $20 per ton.

Mr. LYNCH. Does not the figure go up as high as thirty or thirty-five dollars per ton?

Mr. DAVIS. No. The highest grade of potassium which is sold from Carlsbad, which is muriate of potash of 61- or 62-percent grade, sells for approximately $20 per ton.

Mr. LYNCH. Is that the very highest?

Mr. DAVIS. There is a commercial chemical grade of potash which gets a premium of a few dollars, about $2 a ton.

Mr. LYNCH. The Government figures that we had indicated that it was about $35 per ton.

Mr. DAVIS. They are undoubtedly speaking about the K_2O content of the product. Muriate of potash of a pure grade is 63 percent, and that is the product that sells in the neighborhood of $21 a ton. The potassium content of that is worth about $34 a ton. But that is not the product on which an 85-cent per ton discovery allowance was granted. It was crude ore.

Mr. LYNCH. It is the same potash, is it not? It is from the same mine; is it not?

Mr. DAVIS. But it is a different grade.

Mr. LYNCH. It may be of a different grade, but the discovery value of potash, 85 cents, is a matter of court record, is it not?

Mr. DAVIS. That is correct. There was a discovery value of 85 cents per ton granted.

* * * * * *

[387] Mr. DAVIS. Possibly your figure of $34 a ton is the delivered price to eastern seaboard. That may be where you get your figure. *Of course your percentage depletion does not go on the delivery price. It is f.o.b. basis.* [Italics supplied.]

Mr. LYNCH. *It is f.o.b. mines.* [Italics supplied.]

Mr. DAVIS. *Yes; and that figure is $20 a ton.* [Italics supplied.]

* * * * * *

CARLSBAD, N. MEX., *February 20, 1950.*

[2231] Hon. WALTER A. LYNCH,
Ways and Means Committee,
House of Representatives, Washington, D.C.

DEAR SIR: This is to clarify the colloquy we had in the course of my testimony before the Ways and Means Committee on February 9, 1950, in support of the present rate of percentage depletion for potash.

The depletion of 85 cents per ton based on discovery value fixed by the Board of Tax Appeals in United States Potash Company, Inc. (memorandum decision, August 16, 1941; CCH Dec. 12,046–A) was based on crude ore. Percentage depletion, however, under section 114(b)(4)(B) of the Internal Revenue Code is allowed with respect to refined ore. Said section defines the "gross income from the property" as the gross income from mining and prescribes that "mining" shall be deemed to include ordinary treatment processes normally applied by mine operators to ob-

tain a commercially marketable product. Under subdivision (iv) of said section such "ordinary treatment processes" with respect to potash include crushing, grinding, beneficiation by concentration, etc.

The price for refined potash is, as I testified, $20.13 f.o.b. Carlsbad, N. Mex. From this must be deducted the royalty averaging 50 cents per ton of refined product payable to the Government of the United States or the State of New Mexico, so that the figure to which the 15 percent depletion rate is applied is $19.63, resulting in a deduction of about $2.94 per ton of refined ore ($19.63 plus 15 percent).

It takes between 2.75 and 2.85 tons of crude ore to obtain one ton of the average highest grade potash commercially produced which contains about 61 per cent K_2O and sells for about 20 per ton. Hence, the true comparison is not between a deduction of 85 cents discovery depletion and $2.94 percentage depletion, but between 85 cents multiplied by from 2.75 to 2.85, or from $2.32 to $2.42 and $2.94.

Finally, I should like to reiterate that no percentage depletion is being taken on potash selling at $35 per ton. Thirty-five dollars would be the theoretical price at which pure potash (100 percent K_2O) should sell, but no such mineral is commercially produced. Occasionally, potash running as high as 63 percent K_2O is sold, but 61 percent K_2O is the average highest grade potash which is commercially produced.

I should appreciate it if you would cause this letter to be printed in the record of the hearings in conjunction with my oral testimony.

Respectfully,

F. O. DAVIS,
Vice President and Treasurer,
Potash Co. of America.

* * * * * *

542090—60——27

(House Hearings, Revenue Revision of 1951)

[1621] Statement of Fred O. Davis, Vice President and Treasurer, Potash Co. of America, Carlsbad, N. Mex.

Mr. DAVIS. My name is Fred O. Davis, vice president and treasurer of the Potash Co. of America located at Carlsbad, N. Mex. This statement is submitted in behalf of the Potash Co. of America and other producers of potash in the United States.

The inclusion of potash in the percentage depletion of our revenue acts has been relatively recent, having been included for the first time in 1943. * * * At the time potash was first included for percentage depletion it was recognized that the mineral was unique in its needs because of several features:

* * * * * *

4. Potash is mined in only one small area of the United States, near Carlsbad, N. Mex., where nearly 90 percent of the production is secured. Practically all of the remainder comes from brine deposits in California and Utah.

* * * * *

[1626] Mr. JENKINS. I have one question, Mr. Davis. What does potash consist of or look like in the mines?

Mr. DAVIS. It is a soluble salt. It is usually found with sodium chloride. Potash itself is potassium chloride and it is found with sodium chloride, and *the process consists of separating the potassium from the sodium.* In our case it is raw salt embedded 1,000 feet underground. [Italics supplied.]

Mr. JENKINS. What is its color?

Mr. DAVIS. It is white. It looks very much like table salt.

* * * * *

QUARTZITE

(See "CLAY REFRACTORY AND FIRE", *supra*, pp. 335–342.)

ROCK ASPHALT

(Percentage depletion first allowed beginning with 1942)

Senate Hearings, 1942

(Senate Hearings, Revenue Act of 1942)

[1405] Senator THOMAS. * * *

* * * * *

[1406] The amendment which I submit for the record—and I will ask to be made a part of the record at this point—adds rock asphalt along with metals.

* * * * *

Senator VANDENBERG. What is rock asphalt?

Senator THOMAS. Rock asphalt is a sort of sandy substance originally that was impregnated with oil, but because of the location of the oil pool the oil has drained away, leaving a sand containing more or less of the oil on the sand, which makes it a substance that can be taken from the mine. Sometimes it is a rather solid substance like the crust of a concrete sidewalk, but it is a sand containing oil that can be ground, and it contains enough oil that, when it is *ground* and then put together again and rolled it makes a solid substance again. [Italics supplied.]

Now, that is one form of the rock asphalt.

The second form is found in pools of sand. The sand is more or less black and sometimes you can pick it up on your hand and squeeze it, and you could almost see your oil in the sand.

That sort of asphalt is mixed with more limestone and more sand to make it of a certain consistency.

Then when it is at the proper consistency it is placed on the road or on the street or on the airport landing areas, and rolled cold and immediately it is susceptible of being traveled over, and it is used for the building of roads and for the building of streets and for making, now, runways for airports.

* * * * *

[1409] Statement of GEORGE E. H. GOODNER, Washington, D.C., representing rock asphalt producers.

* * * * *

[1410] Rock asphalt, as the Senator has told you, is a material composed of rock—either limestone or sandstone—and the residuum from petroleum or asphaltum.

It was formed by nature thousands of years ago, by the oil impregnating the porous layers of rock or stone. Then, through some geologic process, the oil was drained off or forced off, leaving the residuum which is asphalt, and when a particle or a piece of this rock asphalt is crushed to the minutest particles, every particle is impregnated with asphalt.

Therefore, it makes a very highly desirable road or airport runway material.

It is mined with steam shovels after being blasted out of position. It is crushed to required size, laid on the road, and rolled cold, and as soon as it is rolled the road is ready for use. [Italics supplied.]

It is waterproof; it is solid; it resists wear

* * * * *

[1411] Senator BARKLEY. We have a number of asphalt deposits in my State which we regard very highly. It is recommended by road builders, and many of our roads have been built with rock asphalt.

As you say, it requires no treatment at all, except the matter of pulverization. [Italics supplied.]

* * * * *

Mr. GOODNER. It stands in a group by itself, because it is a road preparation made by nature, but it is very closely allied to the oil industry, because the residuum from the oil is what, mixed with the rock, makes the product.

Senator BARKLEY. It is natural asphalt, whereas the kind you have to mix with oil is an artificial asphalt?

Mr. GOODNER. It is prepared, and it comes directly in competition with those, although they have enjoyed the 27½ percent depletion allowed to the oil industry, and the rock asphalt enjoys no such allowance.

* * * * * *

[1412] Mr. GOODNER. * * *

* * * * *

Now, this is a small industry—the rock asphalt industry—compared with the ones you have been hearing about today.

Senator CONNALLY. Let me ask you there: Isn't it also true that the rock that it is in has to be a peculiar formation, that every sand wouldn't create rock asphalt?

Mr. GOODNER. That is true.

Senator CONNALLY. And the difference between rock asphalt and other asphalt is that this is in a sand or in a rock. It is porous. Nature just combined the oil and the rock to make a prepared product itself, whereas in the other asphalts it is the residuum or the base of heavy oils, and that is the stuff you see out on the highway, where they heat it, boil it, and then pour it on the rock surface, whereas the rock asphalt is not treated like that but it is laid cold, isn't it?

Mr. GOODNER. That is absolutely correct, Senator.

* * * * *

[Brief for rock asphalt industry appears at pages 1413–1417.]

Senate Debate, 1942

[(88 Cong. Record (Part 6), 77th Cong., 2d Sess.)]

[8022] Mr. THOMAS of Oklahoma.

* * * * * *

[8023] Mr. President, let me say just a word about rock asphalt. Rock asphalt is found, I think, in a number of States. Rock asphalt is a residue of oil. Some time way back in ancient times oil in places was near the surface of the ground. This oil was imbedded in sand. In some way the oil seeped away from the sand but left the sand covered with oil. If we take out this sand which is thoroughly covered with oil and spread it out on the road and roll it cold on the road, in a few minutes' time the road can be traveled in safety and with no injury to such road. That is rock asphalt. It is a product which is used for road building, a product which is used for street building, and a product which is now being used to make the hard-surface runways on thousands of miles of airports throughout the United States. * * *

* * * * *

As I said, the companies which are producing asphalt are small. They operate only in the local community. They get the asphalt as previously stated, from near the top of the ground. *Production is largely a matter of labor.* Not much machinery is required to develop and operate an asphalt mine. The top of the ground is stripped off, and then the rock-asphalt sand is taken out. Then this oil-impregnated and oil-covered sand is spread on the road cold, lev-

eled, and rolled down, and the moment it is rolled the road is ready to travel. [Italics supplied.]

* * * * *

House Hearing, 1947

(House Hearing, Percentage Depletion (1947))

[57] Statement of D. L. STREET, Louisville, Ky., representing Rock Asphalt Industry.

* * * * *

THE ROCK ASPHALT INDUSTRY AND PERCENTAGE DEPLETION—A STATEMENT OF THE NEED FOR CONTINUATION OF PERCENTAGE DEPLETION OF ROCK ASPHALT DEPOSITS.

The following information has been compiled in support of the contention of the rock asphalt industry that percentage depletion should be continued for the industry on a permanent basis.

GEOLOGY AND RESERVES

Rock asphalt was formed thousands of years ago by the infiltration in limestone and sandstone of petroleum having an asphalt base. Thereafter, geologic changes caused the lighter oils of the petroleum to run off or to evaporate, leaving the stone impregnated with asphalt amounting generally to from 5 to 15 percent of the combination.

* * * * *

PRODUCTION AND TRANSPORTATION

The rock asphalt industry as a whole is still in its infancy, although several concerns are producing in excess of 100,000 tons a year.

[58] The production of this resource in the United States during the 10-year period ending in 1940 was as follows:

* * * * *

Production figures for the years following 1940 are not immediately available.

Imports and exports of rock asphalt are negligible. In view of the weight of the product a certain limitation on the market is created by freight charges, but, due to the wide distribution of the deposits, shipment to most of the States is practicable. In fact, Kentucky has shipped rock asphalt to 33 States.

USES

Since "nature made the mixture," *rock asphalt can be used with a minimum of effort,* primarily because it can be laid "cold." [Italics supplied.]

* * * * *

Probably 90 percent of all rock asphalt being produced in the United States is used for paving surfaces such as highways, airport runways, and factory floors. It is also used on tennis courts and playgrounds.

* * * * *

[60] Respectfully submitted.

D. L. STREET,
Louisville, Ky.

Appearing for:

ALABAMA ASPHALTIC LIMESTONE CO.,
Birmingham, Ala.
KENTUCKY ROCK ASPHALT CO.,
Brownsville, Ky.
SOUTHERN ROCK ASPHALT CO.,
Oklahoma City, Okla.
UVALDE ROCK ASPHALT CO.,
San Antonio, Tex.
WHITE'S UVALDE MINES.,
San Antonio, Tex.
CALROCK ASPHALT CO.,
San Francisco, Calif.

Mr. STREET. Rock asphalt was formed thousands of years ago by the infiltration of petroleum with asphalt base, in either sandstone or limestone.

Later on, through geological changes, the oil seeped off or dried up, leaving the stone impregnated with this asphalt, which of course made an asphalt stone.

[61] The deposits are found primarily in Kentucky, Alabama, Texas, Oklahoma, and California, with some deposits in New Mexico, Missouri, Utah, and Colorado.

The material is shipped widely in a number of States although freight charges restrict its distribution.

The material is used almost exclusively for paving purposes. It is unexcelled in one respect for paving purposes: Where a highway has worn out, and it is not necessary to replace that highway entirely, a three-quarter inch or inch spread of natural rock asphalt over the highway will restore the highway without touching the base, unless the base happens to be broken. [Italics supplied.]

This material, being *a natural material,* is equal to or superior to many of the mixes that are used on highways, tennis courts, and in other places where you need a paving material. [Italics supplied.]

* * * * *

SAND AND GRAVEL

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[310]

* * * * *

Statement of J. RUTLEDGE HILL, Chairman, National Sand and Gravel Association, Dallas, Tex.

* * * * *

[315] Mr. MILLS. Mr. Hill, what is the price of sand and gravel which you would use for purposes of percentage depletion?

* * * * *

Mr. HILL. That, as I understand it, sir, would be the selling price less transportation costs.

Mr. MILLS. About 90 cents?

Mr. HILL. The average in the table shows 91 cents, sir.

Mr. MILLS. Then percentage depletion at 15 percent on a 90-cent price would be equivalent to about 13½ cents per ton, would it not?

* * * * *

Senate Hearings, 1950

(Senate Hearings, Revenue Revisions of 1950)

[793] Statement of J. RUTLEDGE HILL, Dallas, Tex., appearing as Chairman, Committee on Taxation, National Sand and Gravel Association.

* * * * *

[794] Mr. HILL. If we find that there is sufficient sand and gravel to justify the acquisition and the possible marketing of it, we acquire the property, and we erect a processing plant, which consists of *crushing, washing, sizing, screening, grading, and recombining,* to form the particular material that the architect or the engineer may specify for a given job. There are certain sizes, small to large, and they must be uniformly graded from small to large; and then the sand must be clean, sharp, well graded, from the 200 mesh sieve, which, by the way, is so small that water won't go through it, up to a quarter inch. [Italics supplied.]

When all that preparation has been made, it is then loaded on to a vehicle for delivery to the user.

* * * * *

The CHAIRMAN. Is your plant generally connected with the gravel pits or the place where you mine it? Do you have to transport it any distance?

Mr. HILL. A relatively short distance, sir. The plant is always relatively close to the point of processing.

The CHAIRMAN. In the case of sand and gravel, you say that is true always?

Mr. HILL. In the case of sand and gravel; yes.

The CHAIRMAN. But there is some transportation cost there, is there?

Mr. HILL. In getting the raw material from the point of extraction to the processing plant.

The CHAIRMAN. *It is necessary to get it to this processing plant and take this step in processing it in order to make it marketable?* [Italics supplied.]

Mr. HILL. That is correct, sir.

* * * * *

Senate Hearings, 1951

(Senate Hearings, Revenue Act of 1951)

[885] Statement of J. RUTLEDGE HILL, Chairman, Committee on Taxation, National Sand and Gravel Association.

* * * * *

In behalf of the commercial sand and gravel industry of the United States, I respectfully request your committee to recommend to the Senate that it concur in the action of the House of Representatives which would add sand and gravel to the list of nonmetallic minerals entitled to percentage depletion.

* * * * *

[889] *Sand, to be usable,* has to be *graded* from very fine particles which will pass the screen that water will not even go through, on up to the larger particles,

and there must be a smooth gradation from the small up to the large, and for that reason 98 percent of the sand found in nature is useless to these industries. [Italics supplied.]

Do I make myself clear?

The CHAIRMAN. Yes, I think I understand you.

Is there any chemical process by which you could take ordinary sand and convert it into usable form?

Mr. HILL. No, Senator. Most of the sand that you have in mind is extremely fine.

The CHAIRMAN. Yes.

Mr. HILL. And the problem is to incorporate and build up a material that goes from fine up to about a quarter inch in size.

* * * * *

House Hearings, 1953

(House Hearings, General Revenue Revision)

[2087] Statement of J. RUTLEDGE HILL, Dallas, Tex., Chairman of Committee on Taxation, National Sand and Gravel Association, in re Topic 38, Depletion and Exploration Expenditures.

* * * * *

[2089] * * * *Industrial sand is a raw material* used principally in the foundry, glass, and chemical industries, but also finding employment for many other purposes. * * * [Italics supplied.]

* * * * *

SHALE

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1953

(House Hearings, General Revenue Revision (1953))

[2099] Statement of NATIONAL CLAY PIPE MANUFACTURERS, INC., Washington 6, D.C.

This statement is presented on behalf of the vitrified clay sewer pipe manufacturers of the United States for the purpose of (1) urging that fire clays and shales be continued on the eligibility list of minerals entitled to percentage depletion, and (2) ask that consideration be given to a more equitable depletion rate for refractory type shales.

* * * * * *

Vitrified clay sewer *pipe* is *manufactured* and sold under rigid specifications by the American Society for Testing Materials. * * * [Italics supplied.]

* * * * * *

The *minerals used* by this industry are found in limited quantities * * *. [Italics supplied.]

* * * * * *

Generally speaking, two types of *materials* are required in the *manufacture* of pipe, i.e., refractory or fire clay and high grade or refractory type shales. The refractory clay helps maintain the shape and dimensions of the product during the burning process and the refractory type shale adds strength and minimum absorption. [Italics supplied.]

* * * * * *

The present law provides percentage depletion rates for clays and shales *used* in the *manufacture* of sewer pipe as follows: [Italics supplied.]

	Percent
Shale	5
Refractory and fire clay	15

The type of shales *usable* in the production of sewer pipe are at least as scarce and as difficult to locate as fire clays, for which a 15-percent depletion rate is provided. Usable refractory type shale is like oil, "it's where you find it" and for that reason such shale should be entitled to the same 15-percent rate that is allowed for refractory and fire clay. * * * [Italics supplied.]

SHELLS: CLAM AND OYSTER

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[471] Statement of W. P. HAMBLEN, Houston, Tex.

Mr. HAMBLEN. Mr. Chairman and gentlemen of the committee, I am W. P. Hamblen, of Houston, Tex. I am appearing on behalf of a number of companies engaged in the production of mineral shell deposits. I am a director and an attorney for the W. D. Haden Co., of Houston, Tex., one of the larger producers of mineral shell in the State of Texas.

The principal *production of mineral shell for commercial use* occurs in the Gulf coast area. This production is obtained by a complicated dredging process from prehistoric deposits in the form of reefs. These deposits are nonmetallic mineral deposits and have been determined so to be by the Federal courts. [Italics supplied.]

* * * * *

[472] The shell industry as we know it began on a very small scale about 40 years ago in and near Galveston, Tex., and has since developed throughout the Gulf coast area. The growth and importance of the shell industry today is readily illustrated by pointing out its history in the south Texas area. At first it was only used as a surfacing material for streets and roads. Then the railroads began to use it as a ballasting material. In 1916, at Houston, the Lone Star Cement Co. opened the world's first cement plant, using this shell as a raw material, and about 10 years later, the Trinity Portland Cement Co. opened a sec-

ond plant in Houston, using mineral shell as a material and as a base in the manufacture of cement.

In 1929 the W. D. Haden Co. opened a plant near Houston, which produced lime from mineral shell. Subsequently, Mathieson and Southern Alkali Corp. opened their Texas plants using mineral shell to make lime. The lime, in turn, is used to make caustic soda and soda ash. Caustic soda, as most of you doubtless know, is used in making soap, rayon, lye, in vegetable-oil refining, in paper making, in oil refining, in wool scouring, and in the manufacture of glass. The availability of caustic soda made from lime produced from shell, caused construction of many plants in Texas for almost all of these processes. One of the plants using caustic soda made from shell is Celanese, established at Bishop, Tex., about 1942. This plant uses mineral-shell caustic soda to make chemicals essential in the manufacture of fabrics, plastics, textiles, drugs, varnishes, lacquers, dyes, papers, fungicides, antifreeze, soaps and antirust material, and many other products, including film for the making of moving pictures.

In 1936 the Champion Paper Co. built its plant in Houston and became a large user of shell transforming it into lime, and in 1940 Dow Magnesium Co. established its plant at Freeport and became one of the world's largest consumers of shell. It makes shell into lime and uses the lime to precipitate magnesium from sea water. The fact that shell is almost a pure calcium carbonate (I understand that it runs from 98½ to 99½ percent pure calcium carbonate), makes it particularly adaptable for the uses I have mentioned.

The Ideal Cement Co. has constructed a cement plant at Houston, using mineral shell as one of its raw materials and the Halliburton cement plant, now under construction at Corpus Christi, is absolutely

dependent upon shell. Today, only about one-fourth of the Texas shell production is used for road surfacing:

* * * * *

[473]

* * * During the war years, *enormous amounts of shell were being used* in construction of airfields, roads to war plants and docks, and the cement plants increased their demand for shell on account of the great demand for cement and Dow Magnesium was making increasing demands due to its strategic position in the war effort. [Italics supplied.]

* * * * *

The equipment for the proper and economic production of shell consists of dredges, tugboats and especially constructed barges, as well as docks and unloading facilities. * * *

* * * * *

Mr. SIMPSON. Are these shells lime, calcium?

Mr. HAMBLEN. They are prehistoric deposits.

Mr. SIMPSON. Chemically what are they?

Mr. HAMBLEN. They make lime largely, used in making cement. They crush them to make cement, mix them with clay.

Senate Hearings, 1950

(Senate Hearings, Revenue Revisions of 1950)

[703]

* * * * *

Statement of W. P. HAMBLIN, Director and Attorney for the W. D. Haden Co., accompanied by W. Parker, President, Parker Bros.

* * * * *

[704] Mr. HAMBLIN. My name is W. P. Hamblin, of Houston, Tex. I am one of the directors and attorney

for the W. D. Haden Co., one of the largest producers of oyster shell.

I have with me Capt. W. Parker, who is president of Parker Bros., who is a producer of oyster shells in the Texas area.

There has been a great deal of confusion about what we mean when we speak of the oyster shell industry. Most people think that we use the shucked shell, or that we are gathering shells from the sea which are continually being replaced. That is not true.

The Government has said that it is a mining operation. It is a fossil shell that has been deposited hundreds of million years ago—we do not know how many. We reach that with a dredging process, going down underneath the bottom of the bays 2 to 4 feet, moving that much silt, and then reaching this fossil shell.

Senator CONNALLY. In other words, the shell is covered up with silt?

Mr. HAMBLIN. The shell is covered up with silt, anywhere from 2 to 4 feet.

Senator CONNALLY. You have to dredge that off?

Mr. HAMBLIN. We have to dredge that off and then get the shell, take it up to the top of our dredges and *wash it and screen it;* and the fines, the smaller shells, go into one barge and the heavier shells go into another, because the cement plants and the chicken-feed plant and the fertilizer plants want the finer shell. The other shell can be used for other purposes. The Dow Chemical Co., for instance, uses a vast quantity of our shell and does not require the fine. I think their monthly requirement is 54,000 yards of shell. Each one of the cement plants in Houston requires approximately a thousand yards a day. The chicken-feed plant will probably require a thousand yards three times a week and so on. [Italics supplied.]

* * * * *

542690—60—28

(Senate Hearings, Revenue Act of 1951)

* * * * *

[858] Statement of W. P. HAMBLEN, Houston, Tex., representing various gulf coast mineral shell producers.

Mr. HAMBLEN. My name is W. P. Hamblen, of Houston, Tex., representing a number of gulf coast shell industries, producing mineral shell.

Mr. Chairman and gentlemen, I have filed a statement with the committee which I would like to ask to be considered as part of the record.

The CHAIRMAN. Yes, sir.

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[859]

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(The statement of Mr. Hamblen is as follows:)

Statement of W. P. HAMBLEN, of Houston, Tex., representing various gulf coast mineral shell producers.

* * * * *

Shell is produced by means of large dredges that bring the shell up from the bottom of the bay, carry it up to the top of the dredge where it goes down chutes [860] and is *washed* continuously and finally delivered into barges. There is a *method on board the dredges of separating the fine shells from the large.* The fine shell is used mostly by the chicken feed industry and the cement plants, although the cement plants have to take some of the larger shell as we are unable to produce enough of the fines from them to operate continuously. The other companies, such as Dow Chemical, Mathieson Chemical Co., and the alkali companies use the larger shell as it is more

adaptable to their use from a processing standpoint. [Italics supplied.]

* * * * *

SLATE

(Percentage depletion first allowed beginning with 1951)

House Hearings, 1951

(House Hearings, Revenue Revision of 1951)

[1646] (The following statements were submitted for the record:)

Statement of WINSTON L. PROUTY, M. C., Vermont, regarding the need for percentage depletion for the slate industry.

I would like to submit for the consideration of the committee a few reasons why I believe the slate industry should be given the benefit of percentage depletion.

As is quite commonly known the slate industry is made up primarily of small businesses. According to the Bureau of Mines there were 80 operators in 1949 doing a business of $12,200,000. This means about $150,000 apiece. The industry is located principally in Pennsylvania, Vermont, and New York State with scattered quarries in Arkansas, California, Maine, Georgia, Maryland, and Virginia. Recent years have seen the slate industry considerably weakened by the following features.

* * * * *

[1647] It seems only equitable that the slate industry should be given the same consideration as is given its competitors. * * *

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(Senate Hearings, Revenue Act of 1951)

[834]

* * * * *

Statement of W. F. BRONKIE, West Pawlet, Vt.

Mr. BRONKIE. My name is W. F. Bronkie, representing the slate industry of the country, particularly the Vermont-New York Slate Association, the Pennsylvania Slate Association, and the slate producers of Maine and Virginia.

Senator HOEY. You may proceed, Mr. Bronkie.

Mr. BRONKIE. We have a very simple request to ask. The slate industry is a very small business. You have in past tax laws recog-[835]nized the percentage depletion factor as important to the mining and quarrying industry.

During all these years, slate has been overlooked. It has been put into the House bill, but it has been tied to a low-cost bulk product, stone, whereas slate is a specialized product, higher in value and quality, and should be given a separate identity, the same as any other competitive or comparative nonmetallic mineral product.

Senator MILLIKIN. What is its state in the earth, as distinguished from granite or marble? Does it present the same appearances? Does it present the same mining problem?

Mr. BRONKIE. Exactly; the same mining problems as talc, feldspar, and other minerals that are already getting the percentage depletion in their own right.

* * * * *

Senator MILLIKIN. Where are your slate quarries located?

Mr. BRONKIE. In a very limited area in Vermont and New York. They run about 25 miles long and 2 or 3 miles wide.

Senator MILLIKIN. They do not occur generally over the United States?

Mr. BRONKIE. There is that one area in Vermont, as I mentioned. Another is in Virginia, around Buckingham and Arvonia.

Senator MILLIKIN. And does commercial production come only from those areas that you have mentioned?

Mr. BRONKIE. Yes, sir.

Senator MILLIKIN. *What are the relative costs of producing the slate, as distinguished from reducing other quarry material to commercial form?* What do you do with a block of slate at the quarry? [Italics supplied.]

Mr. BRONKIE. We first have to quarry it, and get it out of the ground in a whole piece. It is the reverse of an ore mining operation that we try to keep our pieces as large as we can.

Senator MILLIKIN. Yes.

Mr. BRONKIE. And it is brought out and cut up either on a diamond saw or by cold cutting methods. It is put into a working group where it is split and trimmed and given its shape. There are further processes in surfacing, sandrubbing, fitting to setting diagrams for laying on the floor, or drilled for electrical switchboards.

[836] Senator MILLIKIN. You have outlined quite a comprehensive and expensive process.

Senator TAFT. How does it come? In slices?

Mr. BRONKIE. In beds.

Senator TAFT. Yes. But is there something in between? Do you have a layer of slate and then a layer of something else and then a layer of slate?

Mr. BRONKIE. We have impurities in it from place to place.

Senator TAFT. How do you get a piece of slate, or a shingle?

Mr. BRONKIE. *You get a large block out, and a man sits there with a hammer and a chisel and splits it.* [Italics supplied.]

Senator TAFT. He slices it to make it thin?

Mr. BRONKIE. He slices it. It has a natural cleavage in a natural slice. It is peculiar to slate. That is why not all slate has it. We think we have a quarry, but it does not have a good cleavage; so it is not a commercial slate quarry.

* * * * *

Senator MILLIKIN. What would you like to see in this law?

Mr. BRONKIE. That slate be given a separate classification the same as granite, marble, talc, feldspar, vermiculite, and other competitive and comparative products.

Senator TAFT. It is not in the House bill?

Mr. BRONKIE. It is in the House bill, Senator, but it is tied to stone, and stone is a low cost, bulk product. Crushed stone you buy by the ton. Sand and gravel you buy by the ton at a very low figure. All it is is a question of having to go into a bank and dig it out with a steam shovel and put it on a truck. We have a very complicated and expensive development and exploration program to pay for, a big plant to carry. Our problem is exactly the same on a smaller scale, of course, as the oil industry or the copper mining industry or any other mineral product.

Senator HOEY. You want this put over into the other classifications?

Mr. BRONKIE. No. We just want it to be given its own name.

Your law reads now:

In the case of asbestos, sand, gravel, stone (including pumice, scoria and slate), brick and tile clay, shale, oyster shell, clam shell, granite, and marble, 5 percent,

Senator HOEY. What is it you want done? You

mentioned slate in the last. Do you want it mentioned separately?

Mr. BRONKIE. We want it mentioned separately, the same as marble and granite. We do not want it included in stone, because it is not competitive with stone or comparative with it.

* * * * *

[837] Senator MILLIKIN. Do you use the slate for anything but shingles?

Mr. BRONKIE. Yes, sir; we use it for very many products. Electrical switchboards is a very important use of it at the present.

Senator MILLIKIN. Give me more instances of what you do with it.

Mr. BRONKIE. I think we have it in this statement here:

> *Uses.*—Slate is used in a variety of products: namely, natural roofing, roofing granules, siding, electrical switchboards, paints, ceramics, structural slate products, blackboards and bulletin boards, school slates, expanded aggregates, billiard table tops, and has other numerous and miscellaneous uses important to the economy of the country, industrial and chemical.

Senator HOEY. Would you like to have this statement included in the record?

Mr. BRONKIE. Yes, sir.

Mr. HOEY. Mr. Chairman, I suggest that that be included in the record.

The CHAIRMAN. Yes. That will be included in the record.

(The statement referred to is as follows:)

Statement in Support of Percentage Depletion Allowance for Slate Producers by Independent Classification in Bill.

This statement is submitted in behalf of the slate

producers in the Vermont-New York, Pennsylvania-Maryland, Maine and Virginia slate districts. The slate industry has been overlooked heretofore in the development of the application of the concept of percent depletion. The following facts are submitted for your consideration in support of our claim.

FACTS

1. *Small business.*—The slate industry is composed of approximately 80 relatively small companies operating on low-profit margins.

2. *Industry location.*—Slate is a nonmetallic mineral product manufactured in various grades and types and in various States; namely, Vermont, New York, Pennsylvania, Virginia, California, Arkansas, Georgia, Maine, Maryland. Annual total production is about 800,000 tons with a total value of about $12,000,000.

* * * * *

[838]

* * * * *

7. *Quality product.—Slate is* a specialized nonmetallic *mineral product currently having a market value ranging from $10 to $30 per ton.* It should be classified independently as are marble, granite, quartzite, tripoli, etc. Definitely it should not be classified with low-cost bulk products such as stone, shale, sand and gravel that have values per ton only a fraction that of specialized slate products. [Italics supplied.]

* * * * *

[839] USES OF SLATE

Slate is well-suited to engineering uses because of its high strength, low absorption, resistance to weathering and chemical attack, low electrical conductivity, uniformity of composition, and permanent stability

of dimension. Dimension slate or slab slate is used for roofing, electrical panels, architectural panels, laboratory fixtures, sanitary ware, blackboards and bulletin boards, flagstones, and miscellaneous uses. Slate granules are used chiefly in surfacing prepared roofing and siding. Slate flour is used as a filler in putty, wallboard, phonograph records, crayons, blotting paper, linoleum, * * *

* * * * *

[861] Statement of A. C. FORD, Director of Sales, Southern Lightweight Aggregate Corp.

Mr. FORD. Mr. Chairman and gentlemen, my name is A. C. Ford, and I represent the Southern Lightweight Aggregate Corp., in Richmond.

* * * * *

* * * Vermiculite lightweight aggregate has, for some time, received 15 percent depletion allowance, and the present tax bill already passed by the House of Representatives adds Perlite to the list of minerals to receive the same allowance. In order to permit an equitable allowance for competitive products we sincerely request that "slate when used in the manufacture of lightweight aggregate," the mineral used in the production of Solite, be included at the same figure.

Senator MILLIKIN. Is Solite a trade term?

Mr. FORD. Yes, sir.

[862] Senator MILLIKIN. Is it a term that is restricted to some particular outfit?

Mr. FORD. Yes. That is our trade name, Senator, for our material that is composed of lightweight aggregate that is made from slate when used in the production of lightweight aggregate.

* * * * *

Senator TAFT. We had a man here on all slate.

Mr. FORD. On all slate, yes, sir. But this is the "slate when used in the production of lightweight aggregate," which is very, very hard to find in this country at the present time.

* * * * *

Mr. FORD. The Southern Lightweight Aggregate Corp. produces a lightweight aggregate under the trade name of Solite, certain slaty minerals being used as the raw material for its manufacture. In the case of all three; Perlite, Vermiculite, and Solite, the raw material is expanded in certain heating equipment under high temperature, producing a lightweight aggregate suitable for the combination with portland cement to produce concrete products, such as structural concrete, roof slabs, buildings, building units, insulating concrete and precast shapes. The advantageous merits of lightweight aggregate are, the tremendous savings in steel, their high insulating qualities, their inertness, and durability.

* * * * *

[863] True slate is found in Maine, New York, Vermont, Pennsylvania, Maryland, Virginia, and Georgia, along our Atlantic seaboard, and also in Arkansas and California. Slate of this type is ideally suited for production of shingles and similar units. However, there is a distinct difference between the slate we use for the manufacture of our lightweight aggregate and that used for the production of slate shingles and other slate products.

In the slate we use the forces of nature have caused an altering, or softening, of the slate deposit for a depth of 50 feet. The slate in this altered condition is ideal for the production of lightweight aggregate.

This altered slate in our deposit is an extremely unusual occurrence.

* * * * *

House Hearings, 1953

(House Hearings, General Revenue Revision (1953).)

* * * * *

[2078]. (The following material was submitted for the record on topic 38:)

House of Representatives,
Washington, D.C., August 13, 1953.

Hon. DANIEL A. REED,
Chairman, Ways and Means Committee, New House Office Building, Washington 25, D.C.

DEAR DAN: It is my understanding that on Friday, August 14, hearings will be held on item 38, depletion and exploration expenditures, and that the interested parties will be heard.

[2079] It is my wish to again express my interest in this and attach herewith memoranda pertaining to the subject which it is my desire to have incorporated as a part of the hearings.

Sincerely.

DEAN P. TAYLOR,
Member of Congress.

THE SLATE INDUSTRY

INTRODUCTION

Slate is a metamorphic deposit, formed during earth disturbances of geologic time by the action of heat and pressure on shales and other finely divided sedimentary deposits. During this process secondary minerals were formed, principally mica, the crystals of which when properly orientated give to slate its outstanding characteristic of uniform cleavage. This

unusual feature, which is fully developed only in limited deposits of slate within the major slate districts of the United States, makes it possible to cleave slate in slabs for processing in various commercial forms.

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[2080] FACTS

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[2081]

* * * * *

7. Quality product.—*Slate is a* specialized nonmetallic *mineral product currently having a market value ranging from $10 to $50 per ton.* It should be classified independently as are marble, granite, quartzite; tripoli, etc. Definitely it should not be classified with low-cost bulk products such as stone, shale, sand, and gravel that have values per ton only a fraction that of specialized slate products. [Italics supplied.]

* * * * *

THE SLATE INDUSTRY—A SURVEY

* * * * *

[2083]

* * * * *

Slate for roofing is by far the most important product derived from commercial slate. This industry has been active in the United States since the middle of the 19th century. [Italics supplied.]

* * * * *

SODIUM CHLORIDE (SALT)

(Percentage depletion first allowed beginning with 1951)

Senate Hearings, 1951

(Senate Hearings, Revenue Act of 1951)

[908] Statement of LLOYD P. WEBRE, President, United Salt Corp.

* * * * * *

Salt is produced primarily *in rock-salt form and in brine.* The rock salt is produced very much the same way as coal or potash or limestone, and the equipment which is used to produce it is the same. [Italics supplied.]

The units are used in all the mines and the same units exactly can be used for each purpose. In case of the production of brine, it is very similar to the process for producing sulfur, only we do not use any superheated steam; we use cold water. We just pump fresh water down into a salt deposit and force brine back.

* * * * *

[909]

* * * * *

For brine purposes, certain impurities can be removed from salt, *but from rock salt, the salt must be used as such and is not refined,* but is merely treated for human consumption. [Italics supplied.]

* * * * *

[910]

* * * * *

Upon the basis of the figures furnished, the yield per ton in the years listed has been as follows—these are Government statistics, also:

	Yield per ton
1947	$3.25
1948	3.31
1949	3.47

These figures not only show a low return, but also demonstrate that salt as a commodity has not enjoyed the increase which has taken place in the realization upon other commodities. These figures include, of course, salt of all types and methods of production.

* * * * *

[911]

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Upon the basis of statistics released by the Bureau of Mines in its 1949 Minerals Yearbook, the total value of *naked salt* produced in 1949 amounted to approximately $54,000,000. [Italics supplied.] Carried further, this figure may be translated into effect upon Federal income and excess profits taxes as follows:

Value of salt	$54,000,000
Cost of mining, treatment, etc	27,000,000
Gross income from property	27,000,000
Percentage depletion, 15 percent	4,050,000

If it is assumed that the selling and general expenses, interest, and so forth, are 80 percent of the gross income from the property, and that the depletion allowance is limited to 50 percent of the net income from the property, the deduction would be as follows:

Gross income from property	$27,000,000
Selling and general expenses, etc	21,600,000
Net income from property	5,400,000
Limitation at 50 percent	2,700,000

* * * * *

[912]

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Mr. WEBRE. When we say "naked salt," we mean the salt before it is packed, you see, and the average net plant after deduction of production costs, and then 15 percent of that, you see—

* * * * *

It is the most basic of all chemicals. It is used for caustic, chlorine, sodium, and there are just hundreds of things made from salt.

* * * * *

[1010] Statement of J. L. BAYLESS, Jr., President, Jefferson Island Salt Co., Louisville, Ky.

* * * * *

[1011] The most feasible way of providing this incentive is for the Federal Government to allow a percentage depletion on salt, comparable to the depletion allowed on similar minerals such as coal, oil, sulphur, phosphate, etc.

Based on statistics released by the Bureau of Mines in its 1949 Minerals Yearbook the total value of naked salt produced in 1949 amounted to $54,048,226. Assuming a 50-percent cost of extraction, treatment, etc., for the industry, and a 15-percent percentage-depletion allowance, disregarding possible interim excess-profits taxes, the cost to the Federal Government of this depletion allowance would be only about 1½ million dollars per year. * * *

* * * * *

[2390] Statement of E. J. BACHMAN, Vice President, Jefferson Island Salt Co., Louisville, Ky.

* * * * *

[2391] Based on statistics released by the Bureau of Mines in its 1949 Minerals Yearbook, the total *value of naked salt* produced in 1949 amounted to $54,048,-

226. Assuming a 50-percent cost of extraction, treatment, etc., for the industry and a 15-percent percentage-depletion allowance, disregarding possible interim excess-profits taxes, the cost to the Federal Government of this depletion allowance would be only about $1,500,000 per year. * * * [Italics supplied.]

It is, therefore, recommended that Congress provide for a 15-percent percentage-depletion allowance on salt by including the word "salt" in section 114(b)(4) of the Internal Revenue Code of 1950 between the words "rock asphalt" and "phosphate rock."

House Hearings, 1953

(House Hearings, General Revenue Revision (1953))

* * * * *

[2043] Statement of DANIEL PETERKIN, Jr., Member, Executive Committee of Salt Producers Association, and President of Morton Salt Co., Chicago.

Mr. PETERKIN. Mr. Chairman and members of the committee, my name is Daniel Peterkin, Jr. I am president of the Morton Salt Co. of Chicago, and I am appearing here on behalf of the Salt Producers Association.

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[2044]

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Most of the deposits are worked by wells. Water is forced down, and the resulting *brine is evaporated.* In other deposits the salt is mined. [Italics supplied.]

* * * * *

[2046] The CHAIRMAN. I would like to ask you one question. As I understand in salt mining, you force hot water down into the shafts and then pump the salt water out and evaporate it; is that correct?

Mr. PETERKIN. Except that the water need not be hot. The water is forced down by air pressure, which lifts out the brine. It is brought up as brine and evaporated.

Mr. READ. And salt is also mined. Both systems are used.

Mr. PETERKIN. *Both are used; dry salt is mined, and evaporated salt is produced from brine method.* [Italics supplied.]

* * * * *

STONE

(See "LIMESTONE: ALL GRADES • • • PLUS OTHER STONES • • •", *supra*, pp. 363–381.)

SULPHUR

(Percentage depletion first allowed beginning with 1932)

House Hearings, 1932

(House Hearings, Revenue Revision (1932))

[337] Statement of E. T. CUMMINS, Washington, D.C., representing domestic sulphur producers.

Mr. CUMMINS. Mr. Knoblock has asked me to represent him and present certain matters to this committee in which we are jointly interested.

Mr. CRISP. You represent whom?

Mr. CUMMINS. I represent one of the sulphur companies interested in the matter, the Freeport Sulphur Co.

The Freeport Sulphur Co., the Texas Gulf Sulphur Co., and the Duval-Texas Co. ask you to make a slight amendment to section 114(b)(3) of the 1928 revenue act, which deals with depletion of mines, or particularly the oil and gas section of that provision.

* * * * *

542090—60——29

[338] (The brief is as follows:)

Brief on Behalf of Sulphur Producers

Chairman, Ways and Means Committee,
House of Representatives of the United States.

Dear Sir: The following brief is submitted on behalf of the Freeport Sulphur Co., Texas Gulf Sulphur Co., and Duval-Texas Sulphur Co., being all of the producers in the United States of sulphur by the Frasch process; that is, recovery through driven wells. *They represent in excess of 99 percent of the total production of sulphur in the United States.* (See Mineral Industry, 1930, p. 560.) [Italics supplied.]

These producers unite in requesting an amendment to section 114(b)(3) of the revenue act of 1928 so as to include sulphur in the percentage depletion granted to oil and gas wells.

* * * * * *

[339] I. The mining and production of sulphur by the Frasch process by using drilled wells renders this mining operation more similar and analogous to oil and gas wells than to metal mining

The Frasch process of mining sulphur (under which over 99 percent of the production in the United States is obtained) is:

First, to sink a well into the caprock which overlies the rock salt core of the salt dome in which these deposits of sulphur occur. These wells are drilled with a rotary rig similar to that employed in the petroleum industry for work in soft formations. Second, into this same well is pumped water heated under pressure to a temperature above the melting point of sulphur. This melts the sulphur in situ. Third, it is then pumped to the surface by compressed air. The sulphur arrives at the surface in a liquid form.

Fourth, it is then distributed into bins where it is allowed to solidify, for immediate sale and distribution. *The sulphur so recovered* is in excess of 99.5 percent pure and *is of the grade used in commerce. It requires no further treatment or refining to prepare it for the trade.* [Italics supplied.]

The derricks and drilling rigs are identical with those used by oil producing companies and the sulphur dome in operation presents almost the appearance of an operating oil field.

Oil, gas, and sulphur are all discovered and recovered by sinking wells and bringing the deposit to the surface. In some cases natural pressure brings the oil to the surface. In other cases it has to be aided by either pumps or artificially induced pressure, as in sulphur.

II. Similar to oil and gas sulphur is a commercial product at the mine and does not have to be subjected to a further treatment for sale

Sulphur, like oil and gas, has a value as it comes out of the ground. Similar to oil and gas there is an established field price for sulphur which indicates directly [p. 340] the income from the property. In the case of ores of the metals there is no general field price for the ore at the mine and when the taxpayer does his own concentrating, smelting, refining, transporting and marketing, all that is known is the selling price of the refined or final product. Contrasted with this situation of the ores of the metals sulphur, oil, and gas have a field price and no profit derived from the process of their further treatment could be the subject of depletion.

Percentage depletion, therefore, is peculiarly appropriate *for sulphur,* together with oil and gas wells, and *avoids the difficulty existing in the case of metal mines of allocating the proper portion of the income between that which was due to the mining operations*

simpliciter and that which was due to smelting, refining, transporting, etc. [Italics supplied.]

* * * * *

[341] VI. Numerous tax questions arising out of the distribution of depletion dividends will be avoided

* * * * *

We base this application upon the close association of ownership and discovery between sulphur and the oil and gas wells, the multiple nature of the various interests in the sulphur domes and the unique method of producing and mining sulphur, essentially similar to that of producing oil and gas, and *the fact that there is for sulphur,* as for oil and gas, *a field price that avoids any allocation in determining the income to which percentage depletion is applicable.* [Italics supplied.]

Summary of Advantages

* * * * *

All of which facts we submit warrant the classification of sulphur producers of this country for depletion with the oil and gas industry.

Respectfully submitted.

H. F. J. KNOBLOCH.
E. T. CUMMINS.

* * * * *

House Hearings, 1951

(House Hearings, Revenue Revision of 1951)

[1604] Statement of the Honorable CLARK W. THOMPSON, a Representative in Congress from the State of Texas.

* * * * *

[1607] THE MINING AND PRODUCTION OF SULFUR BY THE FRASCH PROCESS

The Frasch process of mining sulfur (under which over 98 percent of the production in the United States is obtained) is:

First, to sink a well into the cap rock which overlies the rock-salt core of the salt dome in which these deposits of sulfur occur. These wells are drilled with a rotary rig similar to that employed in the petroleum industry for work in soft formations. Second, into this same well is pumped water heated under pressure to a temperature above the melting point of sulfur. This melts the sulfur in situ. Third, it is then pumped to the surface by compressed air. The sulfur arrives at the surface in a liquid form. Fourth, *it is then distributed into bins where it is allowed to solidify, for immediate sale and distribution. The sulfur so recovered* is in excess of 99.5 percent pure and *is of the grade used in commerce. It requires no further treatment or refining to prepare it for the trade.* [Italics supplied.]

* * * * * *

TALC

(Percentage depletion first beginning with 1944)

House Hearing, 1947

(House Hearing, Percentage Depletion (1947))

[25] Statement in support of percentage depletion for talc producers before the Ways and Means Committee of the House of Representatives, June 4, 1947.

My name is Henry Mulryan of Glendale, Calif. * * *

* * * * * *

[26] MINING, MILLING, AND PROCESSING

Practically all of the talc mined in the United States is from underground operations. The mining of talc is comparable to the mining of other hard rock minerals, and in some instances presents exceptional hazards and difficulties which may not only

greatly increase costs but actually threaten the loss of the mine entirely.

Where highly specialized grades are desired, the ore itself is selected by hand before being sent to the mill for processing. After the crude ore is received at the mill, it is *crushed, pulverized* and bagged. The type of mill used for the milling depends upon the physical characteristics of the talc and its ultimate use. Increasing amounts are being micronized, as the fineness of the material greatly influences the end to which it can be put. One company uses a flotation plant for processing special grades and other producers have given serious thought of installing similar units. [Italics supplied.]

* * * * *

[34] Statement of Mr. HENRY MULRYAN, Los Angeles, Calif., representing the talc interests.

* * * * *

[36] Mr. REED. Do you find this talc being fine or does it have to be ground from rock?

[37] Mr. MULRYAN. It occurs as a mass of material. All of the material has to be ground in special equipment to very rigid specification before it can be used in the industry.

Mr. REED. You do not find it in beds like you would sand?

Mr. MULRYAN. No.

* * * * *

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[431]

* * * * *

Statement of S. W. Tuttle, Vice President and Secretary, International Talc Co., Inc., New York, N.Y.

* * * * *

I would like to describe briefly the operations engaged in by my company and by other talc companies which influenced the Congress to grant us this depletion allowance. * * *

* * * * * *

[432]

* * * When the ore arrives at the mill it is put through the mill in a continuous process where it is *crushed and ground* to the specifications required by the consumer. [Italics supplied.]

The ground talc is bagged and ready for sale to the consumer. Most talc sales are made by the producing companies directly to the ultimate consumer. For instance, the annual tonnage of International Talc Co. of approximately 50,000 tons, is divided among consuming industries according to our sales records as follows: 65 percent paint, 20 percent ceramic, 5 percent paper, 3 percent rubber, 3 percent plastic, 2 percent textiles, 2 percent miscellaneous.

* * * * * *

[434]

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At this point I would like to bring up one other matter. The Treasury Department here is urging this committee and the Congress to decrease the percentage-depletion allowance for talc from 15 percent to 5 percent. For my company, the Treasury Department has not been content to wait for the Congress, but has undertaken to do this in an administrative manner. Notwithstanding the fact that for the last 57 years my company has sold talc from the Gouverneur and it has been accepted by the trade as talc, the Treasury Department, in its examination of our last returns has allowed us percentage depletion only on that part of our product which it character-

izes as chemically pure talc, thereby cutting down our percentage depletion to a great degree.

There is no such thing in the United States as chemically pure talc and we so stated in our brief before this committee at prior hearings. The Treasury action is in direct conflict with the action of the committee in its award of percentage depletion to commercially marketable talc in 1943 and in 1947. Even the transportation companies have, during this long period of time, established freight tariff recognizing *our product as ground talc.* At no time in the presentation to the committee either in 1943 or 1947 did we profess to mine, mill, or sell chemically pure talc, but on the contrary, we specifically designated our product as *commercial talc.* Nor was the Treasury Department satisfied with this contention. It has gone further and is maintaining that the ordinary processing which I have described in this paper is not an ordinary treatment process as described by the statute. [Italics supplied.]

* * * * *

[491] Statement of HENRY MULRYAN, Glendale, Calif.

* * * * *

My technical training is that of a mining geologist, having graduated from Stanford University in 1924. Since that time I have been engaged exclusively in the nonmetallic-mineral industry.

At the present time I am the executive vice president and general manager of the Sierra Talc & Clay Co., which company operates 14 mines in the States of California, Nevada, New Mexico, and Montana.

* * * * *

[492] In general, *talc,* a nonmetallic mineral, *sells* at a relatively low cost. The costs of operation are high in comparison with the sales price. And a part

of the reason for the low price is due to high transportation rates from the mine to the mill to the ultimate consumer who might be any place in the United States. Further reasons for low price levels and small margins of profits are the highly competitive conditions existing between talc producers. [Italics supplied.]

* * * * *

Statement of A. PRESCOTT LOOMIS regarding percentage depletion for talc.

* * * * *

[2892] All the talc mined and milled in the Gouverneur district of New York State, is essentially of a similar character of good white color, both fibrous and granular in structure. The main productive region lies in Talcville and Fowler, N.Y., a few miles from Gouverneur in St. Lawrence Country. The ore bodies lie at mining depths of sometimes about 900 feet. The mining of talc is as difficult and expensive as metal mining. The type of mining is known as stope mining. Considerable exploration and development work is necessary before mining the ore. The ore is wet drilled and blasted with dynamite. The broken ore is sorted as to grades, granular or fibrous, and also as to oil absorption properties. In other words some types of ore are heavy and others light. The sorted ore is blended and loaded into mining cars underground and transported to the mine shaft at which point it is loaded into mine skips and hoisted to the surface where it is dumped into trucks for transportation to the mills a few miles away. There is a constant danger of flooding of the mines and it is necessary to constantly keep pumps operating to keep the water out. When the ore arrives at the mill it is put through the mill in a continuous process where it is *crushed and ground* to the specifications required

by the consumer. [Italics supplied.] The ground talc is bagged and ready for sale to the consumer. Most talc sales are made by the producing companies directly to the ultimate consumer. For instance, the annual tonnage of International Talc Corp. of approximately 50,000 tons, is divided between consuming industries according to their sales records as follows:

	Percent		Percent
Paint	65	Plastic	3
Ceramic	20	Textiles	2
Paper	5	Miscellaneous	2
Rubber	3		

* * * * *

Senate Hearings, 1950

(Senate Hearings, Revenue Revisions of 1950)

[790] Statement of WESLEY E. DISNEY regarding clarifying amendments to section 204 of H.R. 8920.

* * * * *

[791] Talc has many industrial uses but *there is little or no market for it in its crude form. It must be crushed and ground before it can be sold.* To eliminate any further controversy with the Bureau, I suggest that section 114(b)(4)(B) of the Internal Revenue Code which defines ordinary treatment processes be amended by inserting "talc" after the word "potash" in subsection (iv) so that talc will be listed among those ores which are not customarily sold in the form of the crude mineral product. *Just as in the case of copper, fluorspar, and other ores, talc has no market until after the ordinary crushing and grinding processes have been applied.* * * * [Italics supplied.]

* * * * *

House Hearings, 1951

(House Hearings, Revenue Revision of 1951)

[1584] Statement of S. W. TUTTLE, Vice President and Secretary, International Talc Co., Inc., New York.

Mr. TUTTLE. My name is S. W. Tuttle, vice president and secretary of the International Talc Co., Inc., with main offices located at 41 Park Row, New York, N.Y. We are one of the three talc-producing companies in the Gouverneur mining district of New York State.

* * * * *

[1585] * * * The ore is wet-drilled and blasted with dynamite. The broken ore is sorted as to grades, granular or fibrous, and also as to oil-absorption properties. In other words, some types of ore are heavy and others light. The sorted ore is blended and loaded into mining cars underground and transported to the mine shaft at which point it is loaded into mine skips and hoisted to the surface where it is dumped into railroad gondolas for transportation to the mills a few miles away.

There is a constant danger of flooding of the mines and it is necessary to constantly keep pumps operating to keep out the water. When the ore arrives at the mill it is put through the mill in a continuous process where it is *crushed and ground* to the specifications required by the consumer. [Italics supplied.]

The *ground talc* is bagged and ready for sale to the consumer. Most talc sales are made by the producing companies directly to the ultimate consumer. For instance, the annual tonnage of International Talc Co. of approximately 50,000 tons, is divided among consuming industries according to out sales records as follows: 65 percent paint, 20 percent ceramic, 5 percent paper, 3 percent rubber, 3 percent plastic, 2 percent textiles, 2 percent miscellaneous. [Italics supplied.]

* * * * *

[1586] I want to say that the talc industry is a small industry. The total tonnage mined by all of the talc

companies in this country is only some 350,000 tons, and it is a high-cost operation.

* * * * *

House Hearings, 1953

(House Hearings, General Revenue Revision (1953))

[2033] Statement of HENRY MULRYAN, President, Sierra Talc & Clay Co., South Pasadena, Calif.

* * * * *

[2035]

* * * * *

The crude ore must be *crushed, ground,* and bagged. Conventionally, the talc taken from the mine is first crushed in primary and sometimes in secondary crushers to minus one-half inch material. Fine grinding is then achieved in tube mills, roller mills, hammer mills, mills using fluid energy, Raymond mills, and Hardinge mills, using closed circuits with Sturtevant, Raymond, or other types of air separators. [Italics supplied.]

Although no blending, concentration, or other beneficiation is required, with the exception of a single operation in Vermont, *talc must be ground to be salable.* There is attached as exhibit A the specifications of products sold by Sierra Talc & Clay Co., which products cover all commercial uses. These specifications demonstrate that *talc ore must be finely ground in order to be salable.* Substantially all talc sales are made by the mine operator directly to the ultimate consumer. *There is practically no commercial use for the raw ore until it has been finely ground.* As shown by the respective Mineral Yearbooks of the United States Bureau of Mines, in 1941, 89 percent; in 1943, 92½ percent; in 1948, 97 percent; and in 1950, 89 percent of the total United States

production of talc was required to be finely ground prior to the original sale. [Italics supplied.]

In other words, these grinding processes are not only the ordinary, normal practice of talc-mine operators; they are practically the universal rule. * * * [2036]

* * * * *

The CHAIRMAN. Pardon me. Not only in the face of the statute itself, but without grinding you could not sell the talc in your State?

Mr. MULRYAN. That is correct. *Practically all of it has to be fine ground to be marketable.* [Italics supplied.]

The CHAIRMAN. If it is not allowed to be ground, depletion is of no value to you?

Mr. MULRYAN. We would be out of business.

The CHAIRMAN. Thank you.

* * * * *

[2037]

* * * * *

We therefore ask that section 114(b)(4)(B)(iv) be amended to add "talc" to the list of minerals now contained in that subsection. We think this addition would make clear that Congress intended in section 114 that in the case of talc which is not customarily sold in its crude form, the term "ordinary treatment process" includes crushing and all grinding *necessary to bring the product to a commercially marketable state. We think that is precisely what the law says today and what Congress intended,* because when the law was amended in 1947 to include talc on a permanent basis, Congress acted in the light of testimony by the industry which showed clearly that talc is not customarily sold in its crude form, and that it must

undergo fine grinding to get it into a marketable state. [Italics supplied.]

* * * * *

[2041] Mr. MULRYAN. I would like to add, or to emphasize, that *until the talc is finally ground it has very little commercial use.* [Italics supplied.]

The CHAIRMAN. Mr. Mulryan, when you say that talc is not customarily sold in the crude state, is it my understanding that it is not considered a commercial product until it is ground fine for use?

Mr. MULRYAN. If you will refer back to the first paragraph on page 3, I quote from the Minerals Yearbook showing that certain percentages were sold.

The CHAIRMAN. Yes.

Mr. MULRYAN. Showing that in 1 year about 10 percent, or even as low as 3 percent was sold in the crude form.

The CHAIRMAN. I just wanted to clear that up, that it is not customarily sold in the crude form.

Mr. MULRYAN. That is correct.

The CHAIRMAN. And you have given the percentages, which is in 1 instance 10 percent.

Mr. MULRYAN. That is right.

The CHAIRMAN. Sold in the crude state.

Mr. MULRYAN. That is correct.

* * * * *

Mr. MULRYAN. The final pulverization, making the talc fine, is a part and parcel of the operation of making the talc commercially usable.

* * * * *

[2042] Mr. SIMPSON. But you say there is no market, that is, no substantial market of the product between the initial crushing and the pulverization process.

Mr. MULRYAN. I would go further, and I would say

there is no market for it at that point, that is, between the crushing and the pulverization point.

Mr. SIMPSON. And do you further claim that that is a part of the mining process which must be done in order to make it commercially usable?

Mr. MULRYAN. That statute is very clear and states the ordinary process that should apply. But it is the Treasury Department which has promulgated a new regulation on July 18, excepting the words *"fine pulverization." That is the normal process, in the processing of talc as it is obtained from the mine.* [Italics supplied.]

Mr. SIMPSON. And the amendment you want would do what?

Mr. MULRYAN. We want to clear up the situation so that the word "talc" will occur at the proper place in section 4, where it can be spelled out that the final grinding is an ordinary part of the treatment. * * *

THENARDITE

(Percentage depletion first allowed beginning with 1947)

House Hearing, 1947

(House Hearing, Percentage D[illegible]tion (1947))

[29] Statement in support of 15 percent percentage depletion for thenardite, before the Ways and Means Committee, House of Representatives, June 4, 1947.

DESCRIPTION AND OCCURRENCE

Thenardite is a nonmetallic mineral commonly known as sodium sulfate. It occurs in natural deposits, *some of which are in solution in brines and require processing.* It is found principally in the Western States of California, West Texas, Wyoming, Utah, Nevada, Montana, and Washington. Salt cake,

the manufactured form of sodium sulfate, is produced chiefly in Michigan, Ohio, and Pennsylvania. It occurs in many foreign countries, including Canada, England, Germany (Soviet zone), and Chili. [Italics supplied.]

PRODUCTION AND PROCESSING

Natural salt cake is processed from natural deposits, and different degrees of processing are required depending upon impurities and other chemicals contained therein. Some natural production is obtained by *evaporation*. Byproduct salt cake is produced principally in the manufacture of hydrochloric acid. Substantial quantities are imported. (See appendix.) The tabulation in the appendix shows that annual production of natural sodium sulfates is valued at 1½ million dollars. A reasonable estimate of annual dollar value for byproduct salt cake would be somewhere between 8 and 10 million dollars for the 5 years ending 1945. [Italics supplied.]

The cost of production varies considerably, depending upon impurities and other chemicals contained in the natural deposits or brines. It is a very competitive product, and you will note that over the 5 or 6 years for which statistics are furnished in the appendix, *the value per short ton at producing plants is under $10 per ton.* Ordinarily it cannot be shipped very far on account of freight rates being prohibitive. There are some instances where the freight charges [30] amount to as much or more than the value of the salt cake at the producing point. The producer invariably sells to the ultimate consumer. [Italics supplied.]

* * * * *

(House Hearings, Revenue Revision of 1950)

[2894] Statement regarding percentage depletion for thenardite by American Potash & Chemical Corp., Searles Lake, Calif.

* * * * *

Thenardite is a sodium sulphate, commonly known as Glauber's salts or salt cake. It is usually found in prehistoric oceanic lake beds.

Thenardite has a variety of uses. It is extremely important in the production of wood pulp for craft papers, especially in the southern part of the United States where the paper without the use of thenardite would be too dark for commercial uses. It is important as a mineral stock feed, as a detergent for soap purposes, cleansers, and toiletries. It is used in the glass industry as well as in the sugar industry. It is important in the production of dyestuff and in the mining and mineralogical industry as a flux. It will probably become important in the near future in the manufacture of fuels for jet engines.

The gross production of thenardite in 1934 was 8,192 tons, with a gross value of $20,573. In 1949, after percentage depletion was allowed by the 1947 statute, the production rose to 139,334 tons with a gross value of $1,886,016.

American Potash & Chemical Corp. is engaged at Searles Lake, Calif., in the production of potash, trona, borax, and thenardite, having in 1949 completed a plant at a cost of $5,500,000. In 1949 we spent over $250,000 inside the plant to expand our facilities to produce thenardite alone. We embarked on an entirely new project on Searles Lake for additional production of thenardite which at the time was in extremely short supply.

[2895] *The production of thenardite consists in supplying brine into the air during the winter when the temperature is less than 45°. Glauber's salts separate out at this temperature. In warmer weather we harvest the Glauber's salts from the lake surface, sludge it into the plant, and refine it into thenardite.* [Italics supplied.]

* * * * *

[2895] Prices to the consumers of thenardite have been lowering. In 1948 the per-ton price was $14; in 1950 it is $10.50.

In our plant at Searles Lake we must produce all four of the projects above mentioned. In effect the trona operation would not be economical unless we produce all four major projects—potash, borax, trona, and thenardite.

* * * * *

TRONA

(Percentage depletion first allowed beginning with 1947)

House Debate, 1947

(93 Cong. Record (Part 8), 80th Cong., 1st Sess. (1947))

[9629]

* * * * *

Mr. BARRETT. I want to congratulate the gentleman for bringing in this bill and may I say to him that I think the percentage depletions allowed in this bill are very fair and will be quite helpful in the development of these minerals in the West. I want to say to the gentleman, however, that we have a new development in our State, the mining of trona. *It is quite similar to thenardite in this bill.* The company presently operating has spent in excess of a million dollars in

the development of this mine, building a shaft, and so forth. They must go deep into the ground in order to take out this mineral. It is an entirely new industry in our State. *It is used for the same purpose as thenardite.* It will be developed mainly on the public domain and bring income to the Treasury of the United States by reason of the royalities paid. I am hopeful that it too could be accorded the same percentage depletion as is granted to these other minerals in this bill. [Italics supplied.]

* * * * *

VERMICULITE

(Percentage depletion first allowed beginning with 1944)

Senate Hearings, 1943

(Senate Hearings, Revenue Act of 1943)

[839] Senator WALSH. A memorandum for inclusion in the record has been submitted by Mr. A. T. Kearney of the committee of vermiculite miners which will be inserted in the record at this point.

(The memorandum referred to is as follows:)

* * * * *

[842] MEMORANDUM REGARDING PERCENTAGE DEPLETION FOR VERMICULITE

* * * * *

[843] 7. *Fabricators and distributors of vermiculite products.*—The marketing of vermiculite products embraces three stages. *The ore is mined and sold by the* [844] *mining companies to fabricators or processors in various parts of the United States.* They subject it to a heat-treating process that expands the ore into loose granular form. The fabricators and processors either sell the expanded material to dealers or use it in the fabrication of mixed,

formed, and fabricated products containing vermiculite. The dealers, in turn, sell to the consuming public. [Italics supplied.]

There are today approximately 35 fabricators and processors in the United States. There are approximately 4,000 dealers. * * *

* * * * *

[844] 8. *Effect of proposed legislation on tax revenue.*—If 15 percent depletion were permitted to vermiculite miners, the estimated reduction in taxes for 1942 would have been $32,002.70. As against this loss of revenue, there would be a substantial gain in revenue from fabricators, processors, and dealers.

* * * * *

House Hearing, 1947

(House Hearing, Percentage Depletion (1947))

[42] Statement of JOHN BISHOP, Chicago, Ill., representing the vermiculite interests.

* * * * *

[43] I would like to make a short statement and to file a brief which I have handed to each member of the committee, and I would like permission to have the brief inserted in the record.

Mr. REED. Without objection the brief will be inserted in the record.

(The document referred to is as follows:)

MEMORANDUM ON PERCENTAGE DEPLETION FOR VERMICULITE

Foreword

* * * * *

Vermiculite, a nonmetallic mineral used principally for insulation, lightweight aggregates, and plaster was granted percentage depletion of 15 percent of gross

income in 1943, the allowance to continue until the termination of hostilities in the then war.

* * * * *

I. HISTORY OF THE VERMICULITE INDUSTRY

(a) *Description and location.*

Vermiculite is a nonmetallic mineral. Chemically, it is an aluminum magnesium silicate. * * *

* * * * *

(c) *Mining and milling.*

Mining for vermiculite is done principally in open pits with power-driven equipment, or in tunnel with pick and shovel.

[44] Milling is quite complicated. The processes used vary with the different mines. *Air separation is used on some properties. In others, screening and drying are adequate to produce a marketable concentrate.* Because of the different minerals with which vermiculite in place is associated, it has been necessary for each miner to develop a process that is suitable for his particular deposit. There has never been and is not now any standardized process or equipment for milling vermiculite. [Italics supplied.]

(d) *Uses of vermiculite.*

The product which is derived from the mining and milling operation is vermiculite concentrate. As such, it has no commercial use. *In concentrate form it is sold to processors and fabricators.* The latter subject it to a heat-treating process that expands the mineral in a manner comparable to the popping of corn. In its expanded form it becomes a commercial product. [Italics supplied.]

Among the products presently being manufactured from vermiculite are the following:

* * * * *

The above list is not exhaustive. It merely illustrates the wide range of uses to which the material

is being put. Vermiculite is today an accepted commercial product in a field that was unknown 15 years ago. In many of its uses, it performs functions that no other known material is capable of performing.

(e) *Marketing of vermiculite and vermiculite products.*

The marketing of vermiculite embodies three stages: (1) *The sale of the concentrate to the processors and fabricators;* (2) the processing and sale of the expanded material and fabricated products to dealers; and (3) the sale of the finished product by the dealer to the consuming public. [Italics supplied.]

In the United States today there are 8 miners, approximately 35 processors and fabricators, and approximately 15,000 dealers. * * *

* * * * *

Vermiculite is the basic mineral from which the income of processors, fabricators, and dealers is derived. In this respect, it is comparable to iron, copper, or lead sold by mine owners or operators to furnaces and smelters. Just as the ores are sent to furnaces and smelters whose products are in turn sold to fabricators for the manufacture of countless articles of commerce, *so vermiculite is sold to processors and fabricators to make therefrom a large variety of commercial products.* [Italics supplied.]

Basic metals such as iron, copper, and lead are permitted percentage depletion. Vermiculite occupies the same position in the nonmetallic industry. It should therefore be accorded the same depletion.

* * * * *

[45] IV. THE ARGUMENT FOR PERCENTAGE DEPLETION FOR VERMICULITE

* * * * *

[50] 5. *The rate for vermiculite should be the same as that allowed metal mines.*

(a) *The mining, processing and marketing of vermiculite is comparable to metal mining.*— * * *

* * * * *

(2) * * *

Vermiculite ore is found in association with other rock, such as syenite or pyroxenite. It contains a high-moisture content. *To concentrate it, it is necessary to dry, crush, and screen the crude ore and then put it through an air-separation process.* It equals in complexity the concentration process in metal mining. [Italics supplied.]

* * * * *

[51] Respectfully submitted.

BLACK MICA MINES, INC.,
BEE TREE VERMICULITE MINES, INC.,
UNIVERSAL ZONOLITE INSULATION CO.,
ALEXITE ENGINEERING CO.

* * * * *

[53] Mr. BISHOP. Vermiculite is one of the nonmetallic minerals. It is found in North and South Carolina, Texas, Wyoming, Montana, and Colorado. When mined, it is shipped to manufacturers and fabricators who subject it to a high degree of heat and in that process it expands, something like the popping of corn.

In its expanded form it becomes a commercial product.

There are today 8 miners, 35 processors or fabricators, and approximately 15,000 dealers in the United States. The production for 1946 [54] was approximately 82,000 tons, having a value of approximately $793,000. For the same period, the sales of expanded vermiculite by processors was approximately $5,537,000, and by dealers, approximately $6,645,000.

* * * * *

The principal point that the vermiculite industry makes in its argument for percentage depletion is the one that has been mentioned by some of the previous

witnesses; and that is, if it is not granted percentage depletion it would be discriminated against in favor of the metal mines and other nonmetallics such as sulfur and potash.

* * * * *

House Hearings, 1950

(House Hearings, Revenue Revision of 1950)

[413] Statement of John H. Bishop, Chicago, Ill., representing miners of vermiculite.

* * * * * *

(The prepared statement of Mr. Bishop follows:)

Statement of JOHN H. BISHOP.

I. HISTORY OF PERCENTAGE DEPLETION FOR VERMICULITE

Vermiculite, a nonmetallic mineral, was first granted percentage depletion of 15 percent of gross income in the Revenue Act of 1943. This allowance was made during the war and hence was on a temporary basis. The grant was terminated by Presidential proclamation at the end of 1946. In 1947 Congress, after a study of the problem and after hearings before the Ways and Means Committee, fixed the percentage depletion allowance of vermiculite on a permanent basis at 15 percent of gross income, the allowance, however, not to exceed 50 percent of net income.

* * * * *

III. ARGUMENT FOR RETENTION OF PERCENTAGE DEPLETION AT 15 PERCENT OF GROSS INCOME FOR VERMICULITE

* * * * *

[414] A review of the situation today will show that the conditions which prompted Congress to grant per-

centage depletion in 1947 still exist today. Let us review them briefly:

1. *The allowance will benefit both the miners and the Treasury.*

In hearings before the Ways and Means Committee in 1947, the vermiculite miners argued that if they were granted percentage depletion the industry would be so stimulated that increased rather than reduced revenues would result. The record since the grant of percentage depletion proves conclusively that the argument then presented was correct.

In 1943, the year prior to the first percentage depletion allowance for vermiculite, 46,645 tons of vermiculite were mined and shipped. Tonnage mined and shipped since 1943 is as follows:

	Tons		Tons
1944	54,116	1947	131,385
1945	64,808	1948	138,635
1946	86,390	1949 (estimated)	168,000

Tax revenues from miners during these years are estimated as follows:

1944	$72,000	1947	$106,000
1945	73,000	1948	188,000
1946	96,000	1949	300,000

Vermiculite is a basic mineral which is sold in its crude or concentrated form to processors who exfoliate it and from the processed mineral fabricate many different types of materials, all of which are sold through dealers. The income from the industry, therefore, is derived from three sources: the miners, the processors, and the dealers. [Italics supplied.]

Vermiculite ore in its concentrated form sells for approximately $10 per ton. [Italics supplied.] Exfoliated vermiculite that is sold by processors brings approximately $75 per ton. It is estimated that the mark-up of the dealers over the processor's price is 20 percent. On this basis gross sales by miners,

processors, and dealers for the last 4 years are estimated as follows:

* * * * *

[415] 3. *The rate should be the same because the conditions are the same.*

(a) *The mining, processing, and marketing of vermiculite are comparable to metal mining.*— * * *

* * * * *

Vermiculite mining, processing, and marketing embrace essentially the same operations. Thus:

1. The ore is mined in substantially the same way.

[416] 2. The concentrating process is equally as complicated as that used in metal mining.

Vermiculite ore is found in association with other rock, such as syenite or pyroxenite. It contains a high moisture content. *To concentrate it, it is necessary to dry, crush, and screen the crude ore and then put it through an air-separation process.* It equals in complexity the concentration process in metal mining. [Italics supplied.]

* * * * *

House Hearings, 1951

(House Hearings, Revenue Revision of 1951)

[1612] Statement of JOHN H. BISHOP, Attorney, Chicago, Ill.

Mr. BISHOP. Mr. Chairman and members of the committee, I am appearing here on behalf of the miners of vermiculite, one of the nonmetallic minerals, and I am going to ask leave to incorporate in the record a statement which I have prepared and then very briefly to summarize it. * * *

* * * * *

* * * Vermiculite is what we call a basic mineral in that it is mined in its crude form and then is proc-

essed, and under the processed mineral many products are made. So when we come to consider the question of tax revenue we consider it as coming from *the miners,* from the processors, and from the dealers. * * * [Italics supplied.]

* * * * *

[1613] (The statement referred to follows:)

MEMORANDUM ON PERCENTAGE DEPLETION FOR VERMICULITE

* * * * *

[1615] Since those estimates were made, another year's figures have become available. The trend indicated for previous years carried into 1950. The following table indicates the estimates for the year 1950 [italics supplied]:

Tonnage mined	212,000
Sales by miners[1]	$2,120,000
Sales by processors[1]	15,900,000
Sales by dealers	19,680,000

[1] Bureau of Mines Yearbook fixes $10 a ton as the price of ore and $75 a ton as the price of expanded vermiculite.

* * * * *

* * * In this connection, we must keep in mind that vermiculite is *a basic mineral which is sold in its crude or concentrated form to processors* who expand it and from the processed mineral fabricate many different types of materials, all of which are sold through dealers. The income from the industry, therefore is derived from three sources—the miners, the processors, and the dealers. [Italics supplied.]

Since the depletion allowance relates only to miners, it is at once apparent that the taxes to be paid by processors and dealers would in no way be affected. And of the three classifications, the miners pay the smallest amount of tax. * * * [Italics supplied.]

* * * * *

[1617] Respectfully submitted.

AMERICAN VERMICULITE CO.,
Spruce Pine, N.C.
ZONOLITE CO.,
Libby, Mont.
MIKOLITE CO.,
Encampment, Wyo.

* * * * *

WOLLASTONITE

(Percentage depletion first allowed beginning with 1951)

Senate Hearings, 1951

(Senate Hearings, The Revenue Act of 1951)

[895] Statement of FRED C. FERNALD, General Counsel, GODFREY L. CABOT, INC., accompanied by Charles A. Stokes.

* * * * *

[896] This is the statement of Godfrey L. Cabot, Inc., before the Finance Committee of the United States Senate in support of proposal to add wollastonite to the list of minerals subject to 15 percent depletion under section 114(b)(4)(A) of the Internal Revenue Code.

* * * * *

Wollastonite is a nonmetallic *mineral being* mined and *marketed* today. This calcium metasilicate ($CaSiO_3$) has been used in floor and wall tile, welding rod coatings, alloying agents, and soil conditioners. It is white in color, brittle, and with a fibrous cleavage. It can be produced in large quantities and through *milling* it is *prepared for use in industry.* [Italics supplied.]

Its use pattern is similar to that for talc which is already subject to the 15-percent depletion under section 114(b)(4)(A) of the Internal Revenue Code.

* * * * *

[897] Senator BUTLER. Is it classified as highly critical?

Mr. STOKES. Well, it cannot be classified as highly critical because *the material is not now in commercial production other than in a very small way, and this is a newly developing industry.* [Italics supplied.]

Senator BUTLER. How long has it been known by this name?

Mr. STOKES. The wollastonite mineral has been known probably for 20 or 30 years. The beginning use of wollastonite is only in the last 5 or 6 years, beginnings of the development, that is.

Senator KERR. It is a nonmetallic mineral?

Mr. STOKES. Yes, sir.

The CHAIRMAN. All right, you may proceed.

Senator MILLIKIN. What other minerals does it resemble?

Mr. STOKES. It resembles most closely in its use the talc minerals, pyrophyllite, steatite, and other forms of talc. They are magnesium silicates. This is a calcium silicate.

* * * * *

[899] Mr. FERNALD. * * *

Mr. Chairman, I believe we have permission for Dr. Stokes to read a short statement which he has prepared, which elaborates a little on mine.

* * * * *

Mr. STOKES. My name is Charles A. Stokes.

Gentlemen, as technical head or as head of technical work for our company, I think that there are a few points about this material that might well be brought

out since *it is a new material, relatively a new material.* [Italics supplied.]

The development of the uses of the mineral wollastonite will open up a relatively new mining industry at several locations. The industry will not at this time be limited, however, by the one deposit that we have in mind at the moment working.

[901]

* * * * * * *

* * * The mineral wollastonite and its associated minerals *have no value until mined, crushed, and separated from each other,* so that the situation is a situation analogous to coal, which must be mined, crushed, and freed from slate, and delivered to a shipping point before it be of any value. [Italics supplied.]

Thus, we would request that wollastonite be valued for depletion-allowance calculations similarly to coal.

* * * * * *

Part III: Miscellaneous Materials (Including Industry Publications)

18-19 Mining Congress Journal (1932-33)

(October 1932 issue, page 9)

DEPLETION—GROSS INCOME—THE PROPERTY

By A. W. Dickinson*

On June 6, 1932, at 5 p.m., the Revenue Act of 1932 was approved containing a provision for percentage depletion for coal and metal mines and sulphur. This provision under Section 114(b)(4) reads in part:

> "The allowance for depletion shall be, in the case of coal mines, 5 percentum, in the case of metal mines, 15 percentum, and in the case of sulphur mines or deposits, 23 percentum, of the gross income from the property during the taxable year."

*Staff, The American Mining Congress.

It is generally understood that gross income is the amount of money received for, or the value of the marketable or shipping product of, a natural resource enterprise. The production of coal or ore, of metals or non-metals is carried on from the prospecting and discovery stages with the sole objective of developing and bringing into being a marketable shipping product of value. This value is the gross income.

The whole conduct of mining enterprise is a selective procedure. It most commonly happens that in the selection of a deposit of mineral for production many other deposits are discarded or eliminated from consideration in the desire and plan to operate only such a property as will present the best opportunity for the final winning of a marketable product.

After the selection of the deposit of the mineral is made plans are carefully developed with a view to selecting the coal, ore or mineral to be taken from its place in the earth. Mining men do not take the entire content of the land to which they have claim or title. Coal lies in beds of varying thickness and pitch, and ores and minerals are found in veins and other forms of deposit. The material contemplated in the plan and sought in the selective process of winning to the use of mankind is the marketable material. Thus much of the content of the deposit is discarded in the very method pursued in the working or winning. In coal mining, top or bottom coal or both are frequently left in place. In many instances there is a center band or bed which is cut out and wasted in order that the coal sent to surface may be of a marketable quality. In metal mining the drifts, crosscuts and even shafts change course in the procedure of selecting the ore or mineral which will furnish a marketable product.

There is further the selection practiced in the loading of coal and ore when impurities and waste materials are cast out by hand, hand shovel and mechanical device. From the room, breast, stope, or open pit the coal or ore then proceeds to market, the selective handling continuing en route, until the evolution of mining brings out a product which has value, a product which someone will buy—a MARKETABLE SHIPPING PRODUCT. The further selection accomplished by screens, washing, smelting and refining is contiguous to, and a step in, the production of a marketable natural resource product by mining. Without each of these steps, from prospecting to the marketable product, deposits of mineral could not and would not be won and all of the practices from the prospecting drill, rock breaking coal cutting and loading down to the electrolytic vat are vital to the fruition of a mining enterprise in evolving a marketable product which can be disposed of by the taxpayer.

The individual or group conducting a mining business receives no money until disposal is made of a marketable product. This money is then used to pay for labor, powder, machinery, supplies, taxes and miscellaneous needs. The remainder of the money received for the sale of the marketable product, IF ANY, is the net; the objective of the entire venture from prospecting to disposal. In determining the "gross income from the property" from which the percentage depletion was authorized, Congress could have had in mind no other conclusion than that the money received from the sale of the marketable product was such gross income and that the Congress and its advisers so intended when Section 114(b)(4) of the Revenue Act of 1932 was written and enacted into law.

28 Minidg Congress Journal (1942)

(October 1942 issue)

[48]

WHEELS OF GOVERNMENT

As viewed by A. W. Dickinson of the American Mining Congress

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The American Mining Congress Tax Committee is continuing negotiations with the Treasury for the purpose of arriving at a specific understanding of the meaning of the term "gross income from the property," for purposes of computing the percentage depletion allowance for mines generally and the excess profits tax exemption for strategic minerals, and of restoring [49] the interpretations and practices in effect until recently.

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28 Mining Congress Journal (1942)

(November 1942 issue)

[49]

WHEELS OF GOVERNMENT

As viewed by A. W. Dickinson of the American Mining Congress

* * * * *

[50] *"Gross income from the property"*

When Republican Senator John Thomas, of Idaho, placed percentage depletion for mines in the Revenue Act of 1932 and the Treasury Department wrote the administrative regulations, the doughty Senator and his colleagues in the Congress had the very definite idea that the ordinary ore treatment processes performed by the mine operators were to be considered as a part of the mining operation, and that the cost

thereof should not be deducted in computing the "gross income from the property." Senator Thomas knew that the Bureau of Internal Revenue has recently sought to disallow some of the treatment processes, thereby reducing the computed depletion. While the revenue bill was under debate he engaged in a discussion on the Senate floor with Finance Committee Chairman George and Senator Edwin C. Johnson, of Colorado, in the course of which he inquired whether any change was proposed in the original understanding. Senator Johnson replied that he had discussed the matter with Treasury General Counsel Randolph Paul and gave assurance that no change was contemplated in the regulations and procedures originally adopted by the Bureau of Internal Revenue and followed for many years. He stated that gravity flotation and concentration, or equivalent processes, were included in the mining operation and he said further that the furnacing of quicksilver ores, as an example, had been considered as an equivalent of gravity or flotation concentration.

This exchange of views by the Senators while the Revenue Bill of 1942 was under debate makes a clear record of the intent of Congress not to approve Treasury regulations or bureau practices which depart from the original understandings under the 1932 and 1934 acts.

29.2 Mining Congress Journal (Mar.-Dec. 1943)

(March 1943 issue)

[20] AMERICAN MINING CONGRESS REVIEWS ITS ACTIVITIES IN 1942

Secretary's report to members tells of broadened scope of service to meet wartime needs

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[21]

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Taxes

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The work of our Tax Committee under Chairman Henry B. Fernald, in presenting the true picture of mining and its needs, has again been a most important part of the year's work. In addition to the revenue bill hearings before the Ways and Means and Finance Committees, special hearings [22] on mine taxation were held in the West by a Senate Subcommittee headed by Senator Pat McCarran of Nevada, in which our participation was requested. These developed specific information concerning the effect of taxes upon production, with particular reference to the problems of small mines, which had real value to the government and to the mining industry.

Repeated attacks upon percentage depletion were made by the Treasury in connection with the 1942 Revenue Act. At committee hearings these were answered by eight mining witnesses, from California, Idaho, Utah, Arizona, Oklahoma, Illinois, and West Virginia. A special pamphlet discussing the question in simple language was given wide circulation. By votes of 21 to 4 and 14 to 6, respectively, the Ways and Means and Finance Committees upheld existing depletion allowances, as not only justified but essential to the welfare of the mining industry and the nation. Fluorspar, ball and sagger clay, and rock asphalt were added to the minerals entitled to percentage depletion.

* * * * *

The intention of Congress as to the meaning of "gross income from the property," for computing percentage depletion, etc., was expressed in a floor

debate between Senator Johnson of Colorado and Senator Thomas of Idaho. The Treasury, however, is ignoring this, and insisting on deductions from gross income which seriously reduce the depletion allowance. This is of particular concern at this stage to companies producing gold and silver by the cyanide process, and to producers of certain strategic metals, notably quicksilver. Efforts to obtain a proper interpretation are being vigorously pursued.

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29.2 Mining Congress Journal (Mar.-Dec. 1943)

(December 1943 issue)

[54] WHEELS OF GOVERNMENT

As viewed by A. W. Dickinson of the American Mining Congress

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Tax Bill in Senate

* * * * *

Asking that a definition of "Gross Income from the Property" be placed in the law, Donald H. McLaughlin, a member of the AMC Tax Committee, urged that this be done to confirm the intent of the Finance Committee and the Congress when percentage depletion for mines was written into the law in 1932. He urged the committee to include in the bill the amendment by Senator Edward C. Johnson of Colorado which makes it clear that mining operations are considered as including ordinary treatment processes. The amendment applies the same principles to Sections 731 and 735 of the 1942 Act which exempt strategic minerals, above-quota production and excess output from excess profits tax.

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30 Mining Congress Journal (1944)

(January 1944 issue)

[26] MINING CONGRESS ACTIVITIES IN 1943

Annual report of Julian D. Conover, secretary, at members' meeting, (December 15, 1943)

This 46th Annual Meeting of the American Mining Congress marks the close of one of the most strenuous years in nearly half a century of service to the mining industry. The problems of mining in this second year of the war have been complex, have brought more mining men than ever before into contact with the agencies of the Federal Government, have called to an increasing extent for attention and hard work on the part of your organization.

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[27]

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Concerning our work in Washington I will try to be brief. I could not possibly discuss all aspects, and will merely outline some of the important matters as to which we have either taken the lead, or have cooperated with members of the industry, with members of Congress, or with officials of the Government agencies, in protecting mining's welfare. These include:

TAX LEGISLATION

A subject constantly before us. * * *

* * * * *

In the pending Revenue Bill, percentage depletion was spared a further direct attack through action by the Ways and Means Committee to exclude testimony on this subject. On the other hand, the House bill provides that following the war, percentage de-

pletion allowances shall be discontinued in the case of fluorspar, potash and other minerals to which this right was recently extended. We are supporting an amendment to strike out this termination clause.

Our Tax Committee, under Mr. Fernald, has met frequently. It has made exhaustive study of the effect of existing law and regulations on mining and has made careful recommendations to Congress, for consideration in the pending bill if possible, or in further legislation next year.

The committee, its subcommittees and individual members, and the staff have been active in all these matters—particularly in protecting percentage depletion provisions; in pressing for a clear-cut definition of "Gross Income from the Property" upon which the percentage depletion allowance, the strategic mineral exemption, etc., are computed—as contained in the amendment sponsored by Senator Johnson of Colorado; in presenting a similar definition of "Net Income from theProperty"; * * *

* * * * *

Mr. Fernald has again performed an outstanding service in coordinating and directing this work and in presenting the industry's needs.

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[52] WHEELS OF GOVERNMENT

As viewed by A. W. Dickinson of the American Mining Congress

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Revenue Bill to Senate Floor

* * * * *

The Thomas amendment, which would have stricken the subsection terminating percentage depletion granted to certain minerals in the present bill and in

the 1942 Act at the close of the war, was rejected; potash, however, was authorized to continue to take its percentage depletion after the war although the rate was cut from 23 percent to 15 percent.

* * * * *

The amendment introduced by Senator Edwin C. Johnson of Colorado which places in the bill a definition of "gross income from the property" was first rejected by the Committee and then a week later on December 21 was accepted and approved. Made necessary by the recent denial by the Bureau of Internal Revenue of certain treatment costs in computing "gross income from the property" for purposes of percentage depletion, the amendment specifically defines the term "ordinary treatment processes" as including, in the case of coal—cleaning, breaking, sizing, and loading for shipment; in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and in the case of lead, zinc, copper, gold, silver, or fluorspar ores, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, precipitation (but not including electrolytic deposition), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores.

It is provided that the Johnson amendment shall be effective as if it were a part of the Internal Revenue

Code, the Revenue Act of 1938, the Revenue Act of 1936, the Revenue Act of 1934 and the Revenue Act of 1932, on the date of its enactment.

In the Finance Committee's report, the following language is notable:

"The purpose of the provision is to make certain that the ordinary treatment [53] processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines. The law has never contained such a definition, and its absence has given rise to numerous disputes. The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is, therefore, made retroactive to the date of such original provisions."

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30 Mining Congress Journal (1944)

(February 1944 issue)

WHEELS OF GOVERNMENT

[115] As viewed by A. W. Dickinson of the American Mining Congress.

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Revenue bill to President

On January 21, the Senate passed the Revenue Bill of 1943 with few changes from the form reported in our January issue. The Johnson "Gross Income From the Property" amendment was included as was also that raising the credit for exempt excess output for new coal and iron mines from 1/8 to 1/2 of the net

income, and making this provision retroactive to December 31, 1941. Potash and its crystallization process was specifically included in the definition of gross income. Through the effort of Senator McClellan (Dem., Ark.) an amendment was accepted including barite for percentage depletion at 15 percent. Last was the amendment offered by Senator Elmer Thomas (Dem., Okla.) which would have stricken the House clause terminating the percentage depletion allowance for fluorspar, ball and sagger clay, rock asphalt, flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene (and barite) at the end of the war; the vote on this amendment was close, 38–34.

Shortly before the passage of the bill, Finance Committee Chairman Walter George after expressing his opposition to the Thomas amendment, made some comments which the mining industry will do well to ponder deeply. He said that on the recommendation of the War Production Board a depletion allowance had been granted recently for a number of minerals but that no case had been made out for a permanent depletion rate. Senator George contrasted this action with the original placement in the law of percentage depletion for oil and gas and metals, stating that the original draft was not made in a haphazard manner but was actually done on the basis of a careful investigation and study, as the result of which it was shown that the minerals included were entitled to certain definite percentage rates. These rates, he said were authorized in place of the discovery allowance previously made in the law which had been found extremely difficult to administer.

Commenting further on the minerals recently included for the percentage depletion allowance, the Senator said "it would be a mistake to put these minerals on a permanent percentage depletion basis

at this time without study of the competitive conditions and without demanding that sufficient data be furnished so as to enable the Congress, if it is proper hereafter to fix a permanent deduction for percentage depletion, to say what it should be. We have simply lumped them all together; they are all given 15 percent in computing their taxable income. It certainly will, I must say, upset competitive conditions and widen a gap in the Federal income tax laws as applicable to corporations that will one day, in all probability, lead to the elimination or curtailment of the percentage depletion given to oil and to other materials."

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[116]

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Unfortunately, the Senate amendment increasing the credit for exempt excess output of new coal and iron mines was lost but the Johnson "Gross Income from the Property" amendment is in the bill as sent to the White House, with a change made at the earnest request of the Treasury representatives who feared that the cost of smelting and refining processes might be included in the computation of gross income under the terms of the amendment. As changed, one paragraph (iv) of Section 117(c) now reads—"in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic) cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of proc-

esses used in the preparation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this sub-paragraph shall also be applicable in determining gross income attributable to mining for the purposes of Sections 731 and 735."

The definite statement, in the bill awaiting approval, of this clear-cut definition of gross income by the Senate and House is an example of what can be accomplished by an aroused and unified mining industry, and the sincere thanks of the industry are due to Senator Edwin C. Johnson of Colorado who introduced and fought for the amendment and to Representative Wesley E. Disney of Oklahoma who exercised his rare ability in keeping it in the bill.

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30 Mining Congress Journal (1944)

(November 1944 issue)

[21] THE NEW IDRIA DECISION

Mining industry's contention that percentage depletion be computed on gross sales of the first marketable product upheld. Depletion also allowed on ore mined from old dumps.

By Arthur H. Kent,
Attorney-at-Law,
San Francisco, Calif.

The recent decision of the Circuit Court of Appeals for the Ninth Circuit in *New Idria Quicksilver Mining Company* v. *Commissioner* and three related cases, decided September 22, 1944, is of great interest and importance to the mining industry. Herein the Court, reversing the Tax Court of the United States which has sustained the Commissioner, held that the taxpayers, which were engaged in the mining and

treatment of cinnabar ores, were entitled to use as gross income from the property the total amount received from gross sales of flasked quicksilver. The Commissioner had determined deficiencies based upon the deduction from such gross income of the costs of transporting and furnacing the crushed ores and the condensing, cleaning, and flasking of the quicksilver, together with an assumed profit determined by applying to total profits from quicksilver sales the percentage which the cost of each operation bore to the total cost of all operations involved.

The decision of the court on this point is of great significance in several respects. The court might have rested its decision solely upon section 124 of the Revenue Act of 1943, i.e., the gross income amendment, which added section 114(b)(4) to the Code and retroactively amended prior acts back through the Revenue Act of 1932. While that amendment in terms referred specifically, in the case of quicksilver ores, only to furnacing, the minor processes of condensing, cleaning, and flasking could reasonably be held to be included in the term "furnacing," as being merely the completion thereof and incidental thereto.

The court, however, did not confine its decision in any such fashion. Rather, it declared that it was satisfied on the basis of much consideration of the history of that amendment, that it was merely declaratory of the original intention of Congress that the processes to be excepted in arriving at the first marketable product from quicksilver ores should include the furnacing of the same. The court stated that it could find no basis for legally distinguishing the beneficiation which takes place in the rotary furnace and condensing system from the preceding processes of mining and crushing. It concluded by declaring that the interpretation of the Treasury regulation by the Commissioner

and the Tax Court was not in harmony with the statutes and the intention of the regulation prior to the amendment.

The court in this decision has recognized and adopted the principle, in the case of metalliferous ores which do not have an established or representative field price, that no gross income is realized within the meaning of the statute until the point is reached where by suitable metallurgical treatment a commercially marketable product has been obtained. This principle is equally applicable to such processes as the cyanidation and precipitation of gold and silver ores, the leaching of copper and other ores, the crystallization of potash, and similar processes. The *New Idria* decision therefore constitutes a clear judicial vindication of the interpretation of the statute and regulations which representatives of the industry since 1940 have in vain urged upon the Bureau of Internal Revenue to be the proper one. It also vindicates the contention made by Senators Edwin C. Johnson and John Thomas in the Senate that the gross income amendment conferred no new substantive benefits upon the mining industry but merely clarified the statute by declaring the original legislative intent and policy in specific and unambiguous language. Finally it represents an unmistakable judicial reverse to administrative action wearing the guise of interpretation but in reality derogatory of congressional policy and intent.

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[22] Mr. Robert W. Searls of San Francisco was counsel for the taxpayers throughout this very successful litigation.

There follows the full text of the *New Idria* decision.

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As viewed by A. W. Dickinson of the American Mining Congress

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"Gross income from the property"

In California the U.S. Circuit of Appeals for the Ninth Circuit has reversed a decision of the U.S. Tax Court in which was involved the definition of "gross income from the property" under percentage depletion. In the case of quicksilver mining companies, the Bureau of Internal Revenue had ruled that in computing percentage depletion deduction must be made from gross income of "the cost of transporting, furnacing, condensing, cleaning, etc., in amounts agreed upon together with an assumed profit which was determined by applying to the total profits from sales of quicksilver the percentage which the cost of each operation bore to the total cost of all operations involved in getting the quicksilver to market." Robert M. Searls of San Francisco, attorney for the producers, demonstrated to the Court the lack of any market for crude cinnabar ore and asserted that furnacing of the ore is the equivalent of concentration by gravity or flotation process. In handing down its ruling the Court cited the amendment placed in the Revenue Act of 1943 by Senator Edwin S. Johnson of Colorado, which in defining "gross income from the property" specifies that furnacing of quicksilver ores is an ordinary treatment process. The Court further held that the Johnson amendment is a reaffirmation of the "intent of Congress" when percentage depletion was granted to metals in 1932.

This action of the California Court amply justifies the need for the Johnson amendment, as previously the Bureau [p. 53] had been pressing to cut down the

amount of depletion granted by deducting cost and "proportionate profits" in the case of ordinary treatment processes such as cyanidation of gold ores and the furnacing of quicksilver ores.

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DEPLETION AND RELATED PROBLEMS UNDER THE REVENUE ACT OF 1942

By Henry B. Fernald

[21 Taxes, The Tax Magazine, 141 (1943)]

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[143]

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Gross Income.

The question of what constitutes "gross income from the property" for the purpose of allowing 15% of such gross income, and also as to what constitutes "net income from the property" has been a subject of considerable debate between taxpayers and the Bureau. This started in formulating the Treasury Regulations under the 1932 Act when many taxpayers urged that the proposed Department Regulations did not give to the law the interpretation which had manifestly been intended under the Parker-Shepherd Report of 1929 (Reports to the Joint Committee on Internal Revenue Taxation from Its Staff, Vol. I, Part 8—1929). After extended hearings on this subject before the Assistant Secretary of the Treasury, substantial modifications were made in the Bureau's original proposals and the Regulations as thus finally approved (Regulations 77, Art. 221) stood substantially unchanged until in 1940 when certain apparently minor changes therein were made in 1940 by T.D. 4960 (1940–1 C. B. 38). These changes thus made in the Regulations were in themselves appar-

ently minor in nature and effect, but a more important point is that the Bureau has from time to time, particularly since 1940, been changing its interpretations and procedures. These changes have had particular relation (a) to the point where the "cut-off" should come in computing net income for the metal mines with regard to the processes which were or which were not to be considered, in effect, as part of the mining operation, and (b) to the question of what, if any, profits should be considered as attributable to the further processes as distinguished from the mining operations.

(a) The Regulations themselves had referred to "concentrating (by gravity or flotation) and other processes to the extent which they do not beneficiate the produce to a greater degree * * *." The Bureau's practice under the Regulations had been for many years to consider cyaniding, leaching and certain other processes as essentially equivalent to concentrating by gravity or flotation, and it was only recently that the Bureau had been endeavoring to change its long-accepted procedures and doing this without any corresponding change in the Regulations.

(b) Under the original Regulations, for any processes beyond the concentration or equivalent processes—as for example, smelting and refining—only the *costs* were to be deducted in computing gross income; but the 1940 amendment to the Regulations required that there should be eliminated not merely the *cost* but also the "*proportionate profits attributable*" to such processes. At the time it was understood this meant the profits, *if any*, and that would seem to be its natural meaning. Quite recently, the Bureau has proposed determinations to make an allocation of the entire profits of a mining enterprise ratably on the basis of the relative costs below and beyond the cut-off point.

Details To Be Handled by Regulations.

Manifestly, this raised the question of whether the Bureau was justified in changing the long-established regulations and procedures without any corresponding change in the law and also the question of whether the re-enactment of the law without change served to confirm and approve any departmental rulings or Bureau interpretations which were in effect at the time of re-enactment of the law. There was particular question regarding this in connection with the present Act. It was suggested that to avoid question, a provision should be written into the law as to what was meant by gross and net income from the property and what was meant by income from mining in certain other sections of the law. The Treasury urged that the law should not attempt to deal with such details but that they should be left to be handled under Treasury regulations. There was, of course, recognition that there must be some limit to the amount of detail to be written into the law, but at the same time it was not contemplated that Congress' intent with respect to the law and its application should be considered as changed simply because the law was re-enacted at a time when someone within the Bureau was proposing to make radical changes in the application of prior provisions. This gave rise to a discussion on the floor of the Senate between Senator Thomas and Senator Johnson (Congressional Record, October 19, 1942, p. 8291) in which it is stated that [172] there is no intention in the present law to make any change from the original intent, and Mr. Paul is quoted as having stated the Treasury's intention to adhere to the original regulations and procedures, excepting only "that there would be excluded from gross income from the property not only the cost of further processes such as smelting, but also

the profits, if any, attributable thereto; intending thus to make the charges for a mining company's own smelter compare with those of an independent customs smelter." I suggest that those of you particularly interested in this question read this discussion. Without trying to pass upon its legal effect, I think it makes clear the intention of Congress in this regard.

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BRICK AND CLAY RECORD

[Cover Page:]

BRICK—REFRACTORIES—STRUCTURAL TILE—SEWER PIPE—DRAIN TILE

BRICK AND CLAY RECORD

Vol. 119, No. 5—November, 1951

(Leading clay journal of the world)

* * * * *

[24] CLAY DEPLETION ALLOWANCES GRANTED IN NEW TAX BILL

The President on Oct. 20 signed H.R. 4473, the Revenue Act of 1951 which increases individual income taxes and corporate taxes. A provision of this bill granted 5 percent depletion allowances to brick and tile clay and 15 percent depletion allowances on refractory and fire clay.

Text of Section 319 of the Revenue Act of 1951, dealing with depletion percentages, follows:

* * * * *

The depletion allowances apply to the market value of the raw minerals and cannot exceed 50 percent of the net profits from the property. [Italics supplied.]

BRICK AND CLAY RECORD, *supra*

Vol. 120, No. 1—January 1952

[25] TAKE DEPLETION ALLOWANCE AFTER CAREFUL STUDY

A full calendar year has now elapsed since the effective date (Dec. 31, 1950) of the depletion section of the Revenue Act of 1951. Manufacturers will claim the new percentage depletion on their Federal Income Tax returns for the full year just ended.

The interpretation of where a "commercially marketable product" obtains has still to be definitely established, however, and presents a knotty problem to the clay products and refractories manufacturer.

Current thinking in the structural clay products industry reflects the opinion that the "ordinary treatment" required to obtain a marketable product includes the normal processes of screening, tempering, forming, drying and firing. Most structural clay products firms, therefore, are expected to base their depletion on the gross income from the final burned product.

Due to the fact that there is an established market and regular commerce in fire clay, quartzite, and similar refractory raw materials, the situation in that industry is considerably different. In this case, legal opinion tends to consider that a "commercially marketable product" is produced when the mined material is in a size suitable for shipment. Even those refractory producers who do not normally buy or sell such raw material will probably be required to establish a price for the self-mined materials; such a price to be based on the average market prices of such materials in his particular area. [Italics supplied.]

In the case of the refractory producer in particular,

however, individual analysis by qualified tax advisors must be the watchword. BRICK AND CLAY RECORD has been advised by a tax consultant to strongly urge each refractory firm to obtain qualified, individual tax guidance, since the problem and its solution will be subject to variation in each case.

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[29] NEWS OF THE INDUSTRY

SCPI Committee Issues Depletion Interpretation

A Structural Clay Products Institute Committee consisting of Edwin H. Davis, Norman H. Crissey, and Kenneth W. Dunwoody has issued its interpretation of the new depletion allowance in the form of a memo to the members of the industry. It has requested comments on its interpretation.

Here is the memo in part:

"Section 114(b)(4)A of the Internal Revenue Code as amended provides, that:

A. In General—the allowance for depletion under Section 23(m) in the case of the following mines and other natural deposits shall be—

1. In the case of * * * brick and tile clay * * * 5 per centum * * * of the gross income from the property.

B. Definition of Gross Income From Property.—As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining' as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground **but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products,** and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the

ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plant or mills * * *."

This section defines "**ordinary** treatment processes" in the case of coal, sulphur, iron ore, bauxite, ball and sagger clay, rock asphalt and other minerals. We have no such definitions for treatment processes of brick and tile clay under subparagraph "B" and must therefore interpret the statute from the language used by the Congress.

The word "mineral" in its ordinary and common meaning, generally includes stone and rock deposits, whether obtained from a mine, as the word would seem to imply, or by open Working, and whether containing metallic substances or substances entirely nonmetallic. (58 CJS p. 24)

Unless there are words qualifying or limiting its meaning the term "mineral" as used in instruments and statutes ordinarily includes asphaltum, chrome or chromate of iron, **clay**, coprolites, diamonds, granite, marble, salt, shale and silica * * *.

* * * Treasury Regulations 111, * * * includes "clay" within the definition of minerals.

The statute provides that the term "mining" shall include not merely the extraction of the clay (minerals) from the ground, but also the **ordinary** treatment processes normally applied by mine owners in order to obtain the commercially marketable mineral product or products.

The word "ordinary" is defined in Webster's New International Dictionary to mean "customary, usual, regular." * * *

It is the normal, customary and necessary practice for manufacturers of clay products to burn their pro-

*ductions in order to obtain the commercially marketable product. Raw brick and tile clay does not have a commercially marketable value * * *.*

** * * Under the language of the statute depletion must be based on the value of the burned product * * *.*

** * * For the above reasons, a brick and tile manufacturer has no "commercially marketable product" until the green brick formed of raw brick or tile clay has been burned. The depletion allowance should be based on the gross income from burned brick or tile including the loading for shipment which is the first point at which clay becomes marketable.* [Italics supplied.]

Senate Hearings, 1938

(Revenue Act of 1938, Hearings before the Committee on Finance, United States Senate, 75th Cong., 3d Sess., on H.R. 9682)

[484] Statement of D. A. CALLAHAN, of Wallace, Idaho, representing the American Mining Congress.

Mr. CALLAHAN. Mr. Chairman, I am representing the American Mining Congress and I have here a brief which I will not read, but I just want a few minutes to tell you orally what this is all about.

The CHAIRMAN. Very well.

(The brief referred to is as follows:)

Statement of D. A. CALLAHAN, Wallace, Idaho, on the Revenue Bill of 1938, presented at Hearings of the Committee on Finance, United States Senate, March 19, 1938.

To the honorable Committee on Finance, United States Senate:

I am appearing here in behalf of the American Mining Congress to urge an amendment to section 22(c) of the bill. In doing so I am representing the entire industry from the producer to the fabricator of metal products.

This provision, which is a repetition of the present law, confers upon the Commissioner of Internal Revenue the authority of prescribing the basis of inventories which will clearly determine the income of a taxpayer. Under this law the Treasury Department refuses to permit those engaged in the metal smelting, refining, and fabricating industries to apply current costs to current sales in determining the cost of goods sold. The American Mining Congress urges that this section be amended to permit these industries to use this method.

* * * * *

In order to arrive at an understanding of just what this means, I shall outline the processes through which raw metal must pass before reaching the market as a finished and merchantable product.

First the ore is taken from the ground, is crushed and ground, and the waste material separated usually through what is known as the flotation process. This reduces the metal to the form known as concentrates.

Next the concentrates are shipped to the smelter where they go through several processes before emerging as a merchantable product. Certain of the metals must go through processes of refining in order to remove all impurities.

Metallurgical improvements over the past several years have resulted in the final production of a practically pure form of metal. These processes consume a considerable period of time and during this period the smelter and refiner must carry large inventories because the smelting and refining business is a continuous process and must not be impeded or delayed by lack of metal in the form of concentrates, and the smelting and refining company must carry stocks of refined metal to meet the demands of the market.

In these various steps from the mine to the market of the finished product, there is a community of interest between the producer of the raw materials, the smelter, the refiner, and the fabricator. In a great many cases the producing company makes a contract with a smelting company under the terms of which settlements are made upon the basis of the market price on the day the concentrates are shipped to, or received by, the smelter. This contract provides, among things, for a smelting charge or toll, and in many cases, the smelter acts in effect as the selling agent for the finished product. This is necessary because small producers cannot maintain the selling organization and have not the means which will enable them to wait for returns until the finished product is finally sold to the fabricator. By sampling and assay the exact refined metal content of the concentrates is determined at the time of delivery and the producer is then paid the market price, for the refined metal equivalent of his product, less a specified charge for smelting and refining. At that point the producer's responsibility in respect to that production is terminated and that of the smelter and refiner begins.

Basically, smelting and refining is a custom business and a substantial part of present-day operations are conducted on a direct toll basis. Obviously, however, the small producer of crude ores is not financially able to carry the metals through the smelting and refining period. Accordingly, a substantial part of the business [485] must be conducted on what is known as the ore purchase contract basis which I have described.

Experience has taught the custom smelter and refiner that he cannot afford to speculate on metal price fluctuations. The risk of loss is too great, the processing period is too long, metal prices are subject to extreme and rapid fluctuations. A large part of the price of the refined metals represents the cost of the

crude ores. There is no adequate metal futures market for hedging.

Accordingly, the custom smelter and refiner protects himself by selling the metals produced from the crude ores which have been purchased at the price paid for them. In the absence of a metal futures market there is only one method available for obtaining this result and that method is employed in the industry to the fullest practical limit. It consists of selling, concurrently with the purchase of crude ores, an amount of refined metal equivalent to the metal content of the ore purchased. The price paid for the metals in the ores is thereby matched with the price received for the refined metals. The effect of subsequent fluctuations in metal prices is neutralized, the smelting and refining fee charged the producer is protected, and the profits from operations on the purchase contract basis coincide with those derived from toll operations. This, of course, cannot be carried out with absolute mathematical exactness, but it is the basic buying and selling policy of the industry, and in ordinary times it can be and is carried out with remarkable accuracy. This accuracy results from two factors: (1) Close cooperation between the receiving and selling departments, and (2) the ability to determine the exact refined metal content of the crude ore or concentrates. This second factor is essential to a matching policy and distinguishes the metal-process industries from the ordinary manufacturers who do not and cannot employ it.

Notwithstanding the fact that the custom smelter and refiner conducts his business so as to eliminate the risks of market fluctuations, he is obliged under the present rules of the Internal Revenue Bureau to reflect such fluctuations in the computation of his taxable net income. This result is produced, because he is not permitted to apply the cost of current purchases

against current sales, which conforms to the basis of conducting his business, but is obliged to apply the so-called first-in, first-out rule in determining the cost of goods sold. This latter rule assumes that the raw materials purchased first are used first; and correspondingly, that those purchased last are used last.

This rule cannot fairly be applied to the smelting and refining industry, because in order to operate efficiently the custom smelter and refiner must maintain a substantial amount of stocks on hand. These stocks include: (a) The metal impounded in the system necessary to permit continuous smelting and refining operations, (b) sufficient metals on hand to assure compliance with toll contract commitments, and (c) an adequate supply of metals to carry out the policy of currently selling against intake. The first-in, first-out rule goes back through the entire inventory, picks up the cost of the earliest purchase, and applies it to the present sale. As a result, the entire net fluctuations in market price since the date of the earliest purchase, which was probably several months before, is reflected as profit or loss on each sale of refined metals—although from the business point of view, the sale is made for the very purpose of eliminating the effect of such fluctuations. This introduces a speculative element into the computation of the taxable income which is wholly absent in the conduct of the business.

The method of matching current sales against current purchases has desirable results for both the producer and the processor. It assures the processor of his operating profit or toll and enables him to pay the producer upon delivery of his metal to the smelter. It also assures the producer of a market free from the speculative element which would result if the smelter purchased his metals and held them for future sales. So long as this practice is followed, the method

of accounting employed by the smelter and refiner should conform thereto and taxable net income should be based upon such method.

* * * * *

TRADE DEFINITIONS OF THE VARIOUS "ORDINARY TREATMENT PROCESSES" LISTED IN CODE SECTION 114(b)(4)(B) AND OF THE SPECIFICALLY EXCLUDED PROCESSES

Processes included in "ordinary treatment processes":

Sulphur processes: The processes listed for sulphur, "pumping to vats, cooling, breaking, and loading for shipment" are the processes used in connection with the "Frasch process," under which the sulphur is first liquefied in place by pumping hot water under pressure into drill holes and is then pumped to the surface to vats where it is cooled in a big block and later broken and loaded by power shovels into railroad cars.[1]

Coal processes: The processes listed for coal are "cleaning" (for the purposes of separating out impurities, which may be done by a number of different physical or mechanical processes); "breaking," to reduce the size of the material to put it in shipping form, to make the material more suitable for direct marketing, to free impurities for further removal of impurities, or for all three purposes; "sizing," a process of separating mixed sizes, usually by screening; and loading for shipment.[2]

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[1] See Mineral Facts and Problems, Bulletin 556, Bureau of Mines (1956), p. 848; House Hearings, 1932 (*supra*, pp. 438–439); House Hearings, 1951, *supra*, pp. 440–441.

[2] Mitchell, Coal Preparation, Seeley W. Mudd Series (A.I.M.E., 1950 ed.), pp. 182, 188, 190, 191, 246; Taggart, Handbook of Ore Dressing (1927 ed.), pp. 56, 498; Taggart, Elements of Ore Dressing (1951 ed.), p. 17; Gaudin, Principles of Mineral Dressing (1939 ed.), p. 14; Richards and Locke, Textbook of Ore Dressing (1940 ed.), pp. 104, 497–498, 503, 508, 516.

Other processes included as "ordinary treatment processes"

"beneficiation": This means the enrichment of a material by separating out the worthless from the valuable components without significantly altering the inherent physical and chemical nature of either.[3] In relation to ores, it means preparing the ore for the smelter (by concentration (see *infra*) or otherwise).[4] Thus, in some instances "beneficiation" has a slightly broader meaning than "concentration."

"concentration": This is any process (and there are numerous ones) which separates the valuable constituent (or mineral) from the valueless, or which separates one valuable mineral from another valuable mineral, by essentially physical means.[5] With only slightly different connotations, the following terms are synonymous with concentration: "mineral dressing," "ore dressing," "beneficiation," and "milling."[6]

Types of concentration:

"gravity": The separation of the valuable mineral from the valueless constituent by gravity is a process dependent upon the difference in the specific gravity or density of the mineral and valueless constituent.[7] Coal washing, for instance, depends upon gravity-concentration principles.[8]

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[3] Materials Survey—Copper, U.S. Bureau of Mines with Cooperation of Geological Survey, Department of the Interior (Sept. 1952), Ch. II, p. 26; Werner, Materials Beneficiation Enters New Fields, Battelle Technical Review (Sept. 1959), vol. 8, No. 9, p. 4.

[4] Webster's New International Dictionary (1947 ed.)

[5] Taggart, Handbook of Ore Dressing (1927 ed.), p. 3; Richard and Locke, Textbook of Ore Dressing (1940 ed.), p. 5.

[6] Materials Survey—Copper, *supra*, Ch. II, p. 26.

[7] Taggart, Elements of Ore Dressing (1951 ed.), 105 and 165.

[8] Mitchel, Coal Preparation, *supra*, p. 246; Richards and Locke, Textbook of Ore Dressing (1940 ed.), p. 498.

"flotation": A concentration process which, through the use of chemicals used in water applied to a mixture of finely ground minerals, causes a selective attachment of gas bubbles to one mineral constituent and results in a change of effective specific gravity of that mineral, thus permitting a gravitational separation of components. No significant chemical change is involved.[9]

"amalgamation": A concentration process by which native metals (gold and silver) are separated from nonmetallic worthless minerals as a result of the fact that gold and silver have a greater affinity for mercury while the worthless material has a greater affinity for water. The resulting product (impure gold or silver) is the product which is sent to the smelter or refiner.[10]

"electrostatic": A concentration process under which minerals of different electrical conductivity are separated from each other.[11]

"magnetic": A concentration process whereby some minerals are separated out of a material through electromagnetic attraction.[12]

"crushing": Is an operation or group of operations whereby large lumps are reduced in size. Generally, the minimum size is approximately 1/20 or 1/4 of an inch. (The cited authorities disagree on this). This

[9] Taggart, Elements of Ore Dressing (1951 ed.), p. 246; Taggart, Handbook of Mineral Dressing (1945 ed.), p. 12–01; Werner, Minerals Beneficiation Enters New Fields, Battelle Technical Review (Sept. 1959), vol. 8, No. 9, p. 4.

[10] Taggart, Elements of Ore Dressing (1951 ed.), p. 334; Taggart, Handbook of Mineral Dressing (1945 ed.), p. 14–10; Gaudin, Principles of Mineral Dressing (1939 ed.), p. 473.

[11] Gaudin, Principles of Mineral Dressing (1939 ed.), p. 465; Taggart, Elements of Ore Dressing (1951 ed.), p. 61.

[12] Richard and Locke, Textbook of Ore Dressing (1940 ed.), p. 4; Taggart, Elements of Ore Dressing (1951 ed.), p. 44.

process is used (1) to meet commercial product requirements, (2) for liberation of the mineral components in order to facilitate concentration (separating out the valuable from the valueless components), and (3) a step toward further reduction in size.[13]

"crystallization": A process of solidifying from a liquid into a crystalline form.[14]

"cyanidation": This applies only to gold and silver and employs a dilute solution of sodium or potassium cyanide to dissolve the metals, after which the metal solution is separated from the undissolved valueless constituent through filtration.[15]

"furnacing of quicksilver": A distillation process by which the cinnabar ore of mercury is heated to volatilize the mercury and is followed by condensation of the mercury vapor. This may be done even by a prospector, through use of a small retort.[16]

"grinding": This is distinguishable from crushing only in that it is a later stage in size reduction which produces an extremely fine (or pulverized) material.[17]

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[13] Richards and Locke, Textbook of Ore Dressing (1940 ed.), pp. 5 and 19; Gaudin, Principles of Mineral Dressing (1939 ed.), p. 70; Taggart, Elements of Ore Dressing (1951 ed.), p. 341; Taggart, Handbook of Mineral Dressing (1945 ed.), p. 4–01.

[14] Taggart, Handbook of Mineral Dressing (1945 ed.), p. 14–24; Peele, Mining Engineers' Handbook (1952 ed.), p. 10–398; Mineral Facts and Problems, Bulletin 556, *supra*, pp. 707, 757.

[15] Mineral Facts and Problems, Bulletin 556, *supra*, p. 318; Stoughton and Butts, Engineering Metallurgy (1926 ed.), pp. 347, 348; Peele, Mining Engineers' Handbook (1945 ed.), vol. II, pp. 33–09 through 33–25.

[16] Materials Survey—Mercury, U.S. Bureau of Mines I.C. 7941, pp. 34 and 41.

[17] Gaudin, Principles of Mineral Dressing (1939 ed.), p. 92; Taggart, Elements of Ore Dressing (1951 ed.), p. 388.

"leaching": A process of dissolving metals out of ore by means of a weak chemical solution.[18]

"precipitation": This follows cyanidation and leaching. As applied to cyanidation, it is the process of adding, to the cyanide solution containing gold and/or silver, zinc or another metal which is chemically more active than gold or silver and which results in an ejection of impure gold and/or silver in solid form. In the case of leaching, precipitation (other than electrolytic deposition) is the process of adding, to the leach solution of a metal such as copper, iron or another metal which is chemically more active than the solution metal, and which results in an ejection of the desired impure metal in solid form.[19]

"sintering": A process under which ore is subjected to a high temperature so that fine particles are formed into a porous, clinker-like mass.[20]

"sorting": Hand-picking to separate out the better pieces of broken material; is a crude method of concentration.[21]

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[18] Materials Survey—Copper, *supra*, Ch. II, p. 57; Stoughton and Butts, Engineering Metallurgy (1926 ed.), p. 99; Behre and Arbiter, Distinctive Features of the Mineral Industries, Economics of the Mineral Industries (A.I.M.E., 1959 ed.), p. 69.

[19] Materials Survey—Copper, *supra*, Ch. II, pp. 57–58; Henderson and Bates, Metallurgical Dictionary (1953); Stoughton and Butts, Engineering Metallurgy (1926 ed.), pp. 103, 301 and 348; Peele, Mining Engineers' Handbook (1945 ed.), vol. II, pp. 33–08 and 33–10.

[20] Materials Survey—Iron Ore, U.S. Bureau of Mines with Cooperation of Geological Survey, Department of the Interior (May 1956), Ch. III, p. 13; Roe, Iron Ore Beneficiation (1957 ed.), p. 246.

[21] Taggart, Elements of Ore Dressing (1951 ed.), p. 11; Richards and Locke, Textbook of Ore Dressing (1940 ed.), pp. 100–103; Peele, Mining Engineers' Handbook (1945 ed.), vol. II, Ch. 28, p. 15.

Processes excluded from "ordinary treatment processes":

"electrolytic deposition": A process used in refining a metal, such as copper, by passing electric current through a metal compound solution. The pure metal is deposited on the cathode while the impurities collect as a slime at the bottom of the cell or dissolve in the electrolyte.[22]

"smelting": The process of melting an ore accompanied by a chemical change so that the molten products are different from the substance existing before the conversion to a liquid form. In "thermal" smelting, a fuel is the source of heat.[23] In "electric" smelting the heat is derived from electrical energy.[24]

"refining": The process of removal of impurities from impure metal (the product of the smelter or leaching plant) by (1) heat induced chemical reactions between constituents in molten crude metal, frequently induced or accelerated by the addition of deoxidizers, scavengers and other additives, or (2) by electrolytic methods.[25]

"roasting": Any heating operation for the purpose of driving off volatile matter or to effect certain chemical changes at temperatures below those required for complete fusion.[26]

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[22] Webster's New International Dictionary (1947 ed.); Henderson and Bates, Metallurgical Dictionary (1953 ed.); Stoughton and Butts, Engineering Metallurgy (1926 ed.), p. 95.

[23] Webster's International Dictionary (1947 ed.); Stoughton and Butts, Engineering Metallurgy (1926 ed.), pp. 74 and 87.

[24] Stoughton and Butts, Engineering Metallurgy (1926 ed.), p. 110; Newton, Introductions to Metallurgy (1948 ed.), p. 603.

[25] Stoughton and Butts, Engineering Metallurgy (1926 ed.), pp. 93–94; Webster's New International Dictionary (1947 ed.); Henderson and Bates, Metallurgical Dictionary (1953).

[26] Henderson and Bates, Metallurgical Dictionary (1953 ed.); Stoughton and Butts, Engineering Metallurgy (1926 ed.), p. 79.

CHART OF PRODUCTS IN RELATION TO WHICH VARIOUS BRANCHES OF MINING INDUSTRY SOUGHT PERCENTAGE DEPLETION

Year percentage depletion was first granted	Depletable deposit	Product on which percentage depletion was sought or sponsored before Congress: General description of form in which found	Processes applied, according to industry representatives or sponsors	Product which results from stated processes or was specifically stated to be the marketable product	Legislative references
1932	Coal	Solid	—	Coal	Senate Hearings, 1954, pp. 1409–1413 (App. B, pp. 342–348)
"	Sulphur	Pure solid	Frasch method process	Sulphur	House Hearings, 1932, pp. 339–341 (App. B, pp. 438–440); House 1951, p. 1607 (App. B, pp. 440–441)
	Metal mines:				
	Iron ore	Ore	Concentration for low-grade ore preparation for smelter	Shipping grade iron ore	Senate Hearings, 1942, p. 985 (App. B, pp. 360–361); Senate Hear p. 301 (App. B, pp. 362–363)
	Copper	"	"	Concentrates	See our main brief, Point II B 3
	Gold	"	"	"	"
	Lead	"	"	"	"
	Silver	"	"	"	"
	Zinc	"	"	"	"
1942	Ball clay	Clay	None stated	Ball clay	Senate Debate, 1942, pp. 8021, 8023 (App. B, pp. 327–328); House 1947, pp. 63, 65, 66 (App. B, pp. 328–330); Senate Hearings, 19 (App. B, pp. 330–331)
"	Fluorspar	Rock or ore	Processes somewhat similar to those employed for metallic ores	Fluorspar (ground)	Senate Debate, 1942, p. 8024 (App. B, pp. 349–351); House Hea p. 19 (App. B, pp. 351–352)
"	Rock asphalt	Oil-impregnated rock	Crushing or grinding	Rock asphalt (crushed or ground)	Senate Hearings, 1942, pp. 1406, 1410–1412 (App. B, pp. 407–40 Debate, 1942, p. 8023 (App. B, pp. 410–411); House Hearing, 1947 (App. B, pp. 411–413)
1943	Barite	Barite bearing clay	Concentration by washing and gravitation	Barite (crushed and ground)	Senate Hearings, 1943, p. 968 (App. B, p. 318); House Hearing, 19 (App. B, pp. 318–320)
"	Potash	(1) Solid	Separation from sodium chloride	Potash	House Hearings, 1950, pp. 386–387, 2231 (App. B, pp. 402–405); H ings, 1951, pp. 1621, 1626 (App. B, p. 406)
		(2) In brine	Evaporization, crystallization	Potash	Senate Hearings, 1943, p. 369 (App. B, pp. 401–402)
"	Talc		Crushing, grinding	Talc (ground)	House Hearings, 1947, pp. 26, 37 (App. B, pp. 441–442); House Hea pp. 432, 434, 491, 2892 (App. B, pp. 442–446); Senate Hearings, 1 (App. B, p. 446); House Hearings, 1951, pp. 1585–1586 (App. B, p House Hearings, 1953, pp. 2035–2037, 2041–2042 (App. B, pp. 4
"	Vermiculite	—	Screening and drying and/or air separation	Vermiculite concentrate	Senate Hearings, 1943, pp. 843–844 (App. B, pp. 455–456); Hous 1947, pp. 43–44, 53 (App. B, pp. 456–460); House Hearings, 195 415, 416 (App. B, pp. 460–462); House Hearings, 1951, pp. 1612, B, pp. 462–463)
1947	Bentonite	Clay	Drying, grinding or granulating	Bentonite (crude and ground)	House Hearing, 1947, pp. 66–69 (App. B, pp. 320–322); Senate Hea pp. 447–450 (App. B, pp. 322–325)
"	China (or kaolin) clay	Clay	None stated	China clay, f.o.b. mine	House Hearings, 1950, p. 329 (App. B, pp. 334–335)
"	Phosphate rock	Rock	Sintering or nodulizing for low-grade rock	Phosphate rock	House Hearings, 1950, p. 382 (App. B, p. 397); House Hearing 1637–1638 (App. B, p. 398); Senate Hearings, 1954, pp. 1335, 13 pp. 399–401)
"	Thenardite (or salt cake)	(1) Solid	None stated	Thenardite	House Hearings, 1947, pp. 29–30 (App. B, pp. 451–452); House He
		(2) In brine	Separating, sometimes by evaporation	"	pp. 2894–2895 (App. B, pp. 453–454)
"	Trona	—	—	Trona	House Debate, 1947, p. 9629 (App. B, pp. 454–455)
1951	Asbestos	—	—	Asbestos fibers as a raw material	Senate Hearings, 1951, pp. 866–868 (App. B, pp. 316–318)
"	Borax	(1) Solid	None stated	Crude, white soluble powder	House Hearings, 1950, pp. 2887, 2890 (App. B, pp. 325–326); Sena 1951, p. 1060 (App. B, p. 326)
		(2) In brine	—	"	
"	Dolomite	Stone	—	Crushed stone	Same citations as for "limestone, ordinary", *infra*
"	Fire and refractory clay	Clay	None stated	Clay as a raw material used in manufacturing refractory products	House Hearings, 1950, pp. 449–450, 455–463 (App. B, pp. 336–340
"	Fuller's earth	Clay	None stated	Fuller's earth	House Hearings, 1951, pp. 1618–1619 (App. B, pp. 352–353)
"	Garnet		None stated	Garnet	Senate Debate, 1951, p. 12218 (App. B, p. 354)
"	Granite		—	(1) Crushed stone	Same citations as for "limestone, ordinary"; also, House He p. 2890 (App. B, pp. 356–357); Senate Hearings, 1951, p. 10 p. 357); Senate Hearings, 1954, p. 1213 (App. B, p. 358)
			Asked for but was not granted advanced processing	(2) Dimension stone	Senate Hearings, 1954, pp. 1213–1215 (App. B, pp. 358–360)
"	Limestone, ordinary (calcium carbonates)	Stone	—	Crushed stone	House Hearings, 1950, pp. 480–483, 487–490 (App. B, pp. 363– Hearings, 1950, pp. 808–809, 811 (App. B, pp. 370–372); Hou 1951, pp. 1631–1636 (App. B, pp. 373–376); Senate Hearing 891–895 (App. B, pp. 376–379); House Hearings, 1953, p. 21 pp. 379–381)
"	Limestone, chemical grade	Stone	—	Crushed stone	Same citations as for "limestone, ordinary," plus House He pp. 332–340 (App. B, pp. 381–386); House Hearings, 1951, pp 1566–1569 (App. B, pp. 387–390); Senate Hearings, 1951, pp. (App. B, pp. 390–392); House Hearings, 1953, pp. 2091–20 pp. 392–394)
"	Limestone, metallurgical grade	Stone	—	Crushed stone	Same citations as for "limestone, ordinary" and for "limestone, ch
"	Magnesite	Rock	Crushing, concentration, burning	Dead-burned magnesite	House Hearings, 1953, pp. 2059–2060 (App. B, pp. 394–395)
"	Marble	Stone	—	Crushed stone	Same citations as for "limestone, ordinary"
"	Quartzite	—	None stated	Quartzite as a raw material used in manufacturing refractory products	Same citations as for fire clay
			(screening)	Sand and gravel	House Hearings, 1950, p. 310 (App. B, pp. 413–414); Senate He

"	Fluorspar	Rock or ore	Processes somewhat similar to those employed for metallic ores	Fluorspar (ground)	(App. B, pp. 330–331)
"	Rock asphalt	Oil-impregnated rock	Crushing or grinding	Rock asphalt (crushed or ground)	Senate Debate, 1942, p. 8024 (App. B, pp. 349–351); p. 19 (App. B, pp. 351–352)
1943	Barite	Barite bearing clay	Concentration by washing and gravitation	Barite (crushed and ground)	Senate Hearings, 1942, pp. 1406, 1410–1412 (App. B, Debate, 1942, p. 8023 (App. B, pp. 410–411); House H (App. B, pp. 411–413)
"	Potash	(1) Solid	Separation from sodium chloride	Potash	Senate Hearings, 1943, p. 968 (App. B, p. 318); House (App. B, pp. 318–320)
		(2) In brine	Evaporization, crystallization	Potash	House Hearings, 1950, pp. 386–387, 2231 (App. B, pp. 4
"	Talc		Crushing, grinding	Talc (ground)	ings, 1951, pp. 1621, 1626 (App. B, p. 406)
					Senate Hearings, 1943, p. 369 (App. B, pp. 401–402)
"	Vermiculite	—	Screening and drying and/or air separation	Vermiculite concentrate	House Hearings, 1947, pp. 26, 37 (App. B, pp. 441–442); pp. 432, 434, 491, 2892 (App. B, pp. 442–446); Senate (App. B, p. 446); House Hearings, 1951, pp. 1585–1586
					House Hearings, 1953, pp. 2035–2037, 2041–2042 (Ap
1947	Bentonite	Clay	Drying, grinding or granulating	Bentonite (crude and ground)	Senate Hearings, 1943, pp. 843–844 (App. B, pp. 455–1947, pp. 43–44, 53 (App. B, pp. 456–460); House H 415, 416 (App. B, pp. 460–462); House Hearings, 1951 B, pp. 462–463)
"	China (or kaolin) clay	Clay	None stated	China clay, f.o.b. mine	House Hearing, 1947, pp. 66–69 (App. B, pp. 320–322); pp. 447–450 (App. B, pp. 322–325)
"	Phosphate rock	Rock	Sintering or nodulizing for low-grade rock	Phosphate rock	House Hearings, 1950, p. 329 (App. B, pp. 334–335)
					House Hearings, 1950, p. 382 (App. B, p. 397); House 1637–1638 (App. B, p. 398); Senate Hearings, 1954, p pp. 399–401)
"	Thenardite (or salt cake)	(1) Solid	None stated	Thenardite	House Hearings, 1947, pp. 29–30 (App. B, pp. 451–452); pp. 2894–2895 (App. B, pp. 453–454)
"	Trona	(2) In brine	Separating, sometimes by evaporation	"	
1951	Asbestos	—	—	Trona	House Debate, 1947, p. 9629 (App. B, pp. 454–455)
"	Borax	—	—	Asbestos fibers as a raw material	Senate Hearings, 1951, pp. 866–868 (App. B, pp. 316–31
		(1) Solid	None stated	Crude, white soluble powder	House Hearings, 1950, pp. 2887, 2890 (App. B, pp. 325–1951, p. 1060 (App. B, p. 326)
"	Dolomite	(2) In brine	—	"	
"	Fire and refractory clay	Stone	—	Crushed stone	Same citations as for "limestone, ordinary", *infra*
		Clay	None stated	Clay as a raw material used in manufacturing refractory products	House Hearings, 1950, pp. 449–450, 455–463 (App. B, p
"	Fuller's earth	Clay	None stated	Fuller's earth	House Hearings, 1951, pp. 1618–1619 (App. B, pp. 352
"	Garnet		None stated	Garnet	Senate Debate, 1951, p. 12218 (App. B, p. 354)
"	Granite		—	(1) Crushed stone	Same citations as for "limestone, ordinary"; also, p. 2890 (App. B, pp. 356–357); Senate Hearings, p. 357); Senate Hearings, 1954, p. 1213 (App. B,
			Asked for but was not granted advanced processing	(2) Dimension stone	Senate Hearings, 1954, pp. 1213–1215 (App. B, pp. 358
"	Limestone, ordinary (calcium carbonates)	Stone	—	Crushed stone	House Hearings, 1950, pp. 480–483, 487–490 (App. B Hearings, 1950, pp. 808–809, 811 (App. B, pp. 370 1951, pp. 1631–1636 (App. B, pp. 373–376); Sena 891–895 (App. B, pp. 376–379); House Hearings, pp. 379–381)
"	Limestone, chemical grade	Stone	—	Crushed stone	Same citations as for "limestone, ordinary," plus pp. 332–340 (App. B, pp. 381–386); House Hearing 1566–1569 (App. B, pp. 387–390); Senate Hearings, (App. B, pp. 390–392); House Hearings, 1953, p pp. 392–394)
"	Limestone, metallurgical grade	Stone	—	Crushed stone	Same citations as for "limestone, ordinary" and for "lim
"	Magnesite	Rock	Crushing, concentration, burning	Dead-burned magnesite	House Hearings, 1953, pp. 2059–2060 (App. B, pp. 394
"	Marble	Stone	—	Crushed stone	Same citations as for "limestone, ordinary"
"	Quartzite	—	None stated	Quartzite as a raw material used in manufacturing refractory products	Same citations as for fire clay
"	Sand and gravel		Crushing, washing, sizing (screening), grading, recombining	Sand and gravel	House Hearings, 1950, p. 310 (App. B, pp. 413–414); pp. 793–794 (App. B, pp. 414–415); Senate Hearings pp. 415–416); House Hearings, 1953, p. 2089 (App
"	Shale		None stated	Shale	House Hearings, 1953, p. 2099 (App. B, pp. 416–417)
"	Shells (oyster and clam)		Washing and screening	Shells	House Hearings, 1950, pp. 471–473 (App. B, pp. 418 1950, p. 704 (App. B, pp. 420–421); Senate Hearing pp. 422–423)
"	Slate		Hand slicing	Slate (principally for roofing)	House Hearings, 1951, p. 1646 (App. B, p. 423); Sen 834–839 (App. B, pp. 424–427); House Hearing (App. B, pp. 431–432)
"	Sodium chloride (salt)	(1) Solid	—	Crude or "naked" salt	Senate Hearings, 1951, pp. 908–912, 1061, 2391 (App.
		(2) In brine	Evaporation	Salt	House Hearings, 1953, pp. 2044, 2046 (App. B, pp. 436
"	Stone		—	Crushed stone	Same citations as for "limestone, ordinary"
"	Wollastonite		Crushing and separation from other minerals	Wollastonite	Senate Hearings, 1951, pp. 896–897, 901 (App. B, pp. 4

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BRIEF FOR THE RESPONDENT

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959

No. 513

UNITED STATES OF AMERICA,
Petitioner,

v.

CANNELTON SEWER PIPE COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

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IN THE

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OCTOBER TERM, 1959

No. 513

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Petitioner,

v.

CANNELTON SEWER PIPE COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The District Court wrote no opinion. Its findings of fact and conclusions of law (R. 3-7) are not officially reported. The opinion of the Court of Appeals (R. 266-74) is reported at 268 F.2d 334.

JURISDICTION

The judgment of the Court of Appeals was entered on June 15, 1959. (R. 275) By order of Mr. Justice Clark, dated September 10, 1959, the time for petition-

ing for a writ of certiorari was extended to November 12, 1959. (R. 276) The petition for a writ of certiorari was filed on November 4, 1959, and was granted on December 14, 1959. (R. 276). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the substantive questions raised by the Government are available for decision on this Record.

2. On the merits: The taxpayer produced burnt clay products (principally sewer pipe) from fire clay and shale which it mined from its underground mine. Except for a negligible amount of ground fire clay and shale, it sold no fire clay or shale, and there was no market which was economically available to it. Although fire clay and shale are sold in some locations, principally when produced as a by-product of strip-mining for coal, the great majority of fire clay and shale miners process their material into burnt clay products.

Under the statute, percentage depletion is computed as a percentage of the "gross income from mining." This term is defined as follows:

> "The term 'mining' as used herein shall be considered to include *not merely* the extraction of the ores or minerals from the ground *but also* the ordinary treatment processes normally applied by mine owners or operators in order to obtain the *commercially marketable mineral product or products* . . . ." (Italics ours.)

The question is whether the "commercially marketable mineral product or products" of the taxpayer are the burnt clay products which the taxpayer could and

did sell, or whether they are the raw fire clay and shale which the taxpayer did not sell and could not commercially market.

STATUTES AND REGULATIONS INVOLVED

The statutory provisions involved are Sections 23 (m), 23(n), and 114(b)(4) of the Internal Revenue Code of 1939. The regulation involved is Section 29.23(m)-1(f) of Treasury Regulations 111, as amended by T.D. 6031, 1953-2 CUM. BULL. 120. These provisions are set forth in Respondent's Appendix I, pages 121-28 *infra*.

STATEMENT

Because the Government's statement of the case (Br. 3-5) is incomplete, we shall set forth the facts in the record of this case relevant to the issue presented here. The Government does not contend that any of the findings of fact of the District Court are erroneous or not sustained by the evidence. All of the facts stated herein are uncontroverted.

During its taxable year ended November 30, 1951, taxpayer was engaged in the business of mining fire clay and shale (in the proportions of 60% fire clay and 40% shale) from an underground mine which it owned and operated; transporting the minerals in trucks a distance of 1.5 miles to its plant in Cannelton, Indiana; and producing from such fire clay and shale vitrified sewer pipe, flue lining, and related vitrified products. (Fdgs. 7, 8; R. 4)

The processes applied by taxpayer to its fire clay and shale to obtain such products were grinding the clay; mixing it with water in a pugmill to form a

plastic mass; forming this mass in the shapes desired; drying these shapes to remove the added water; firing them in kilns to harden and vitrify them; and cooling the burnt clay products and removing them from the kilns. (R. 21-23, 95) All of the processes used and applied by taxpayer to the fire clay and shale which it mined and used were processes normally applied by mine owners or operators in producing such burnt clay products. (Fdg. 10; R. 5)

All clays and shales are not suitable for making sewer pipe. (R. 120) The clay used must have plasticity, particular drying qualities, and ability to withstand the high temperatures required for vitrification (*i.e.*, firing to a very hard, glazy state). (R. 25-26, 121) Finding suitable clays requires considerable prospecting, and laboratory and production testing. (R. 26-27, 120-21)

The taxpayer mined fire clay and shale from beneath a vein of coal known as "Cannelton Coal" which is the lowest coal formation in Indiana (R. 115); the fire clay mined by taxpayer, known as the Cannelton clay, is the oldest (and deepest occurring) clay mined in Indiana (R. 33, 115-16) and yields the best sewer pipe which is made in Indiana. (R. 127) In 1951, no one else used the Cannelton formation of clay. (R. 33-34) The taxpayer's cost, without the allocation of any overhead, of extracting the fire clay and shale from its underground mine and transporting it to its plant, was $2.418 per ton in 1951. (R. 39, 54; Gov't Ex. C, R. 56, 244)

Taxpayer has never sold any of its raw fire clay or

shale and has never purchased any fire clay or shale for use in its production. (Fdg. 11; R. 5) All of the fire clay and shale mined by taxpayer during its fiscal year 1951 (38,473 tons) was used by it in producing its burnt clay products, except for the sale of approximately 80 tons of ground fire clay and shale in bags at an average price of $22.88 per ton. (Fdg. 9; R. 4-5)

During 1951, the other producers of clay products in the immediate Cannelton area did not sell or buy any raw clay and there were no mine owners or operators in such area who mined and sold clay to others. (R. 33) There were substantial sales of fire clay in Indiana in 1951, but 99% of these were in the area of Brazil, Indiana (R. 137), about 140 miles from Cannelton. (R. 44) The Court of Appeals correctly stated (R. 271) that these sales were made by companies falling into two categories: (1) "operators who engage primarily in strip mining of coal and, who, during their operations, strip bare so-called underclay which they sell as a by-product"; and (2) "those which mine underclay which has already been laid bare by previous strip mining operations." (R. 73, 82-83, 84, 88-89, 135-36, 148, 151, 152, 157, 159, 160) Several of these operators could not find a market for all the clay they had available for sale. (R. 136, 152, 160) As the Court of Appeals stated (R. 270, 272) out of the many companies mining fire clay and shale in Indiana in 1951, only seven producers of fire clay, two of whom also produced shale, sold their raw clay and shale without further processing (R. 72-73, 82-83, 136, 148, 151, 152, 157), and "the integrated miner-manufac-

turer was the rule rather than the exception in Indiana, in 1951." (R. 135)[1]

The mining costs of the strip miners in the Brazil area were low and, as the Court of Appeals stated (R. 271), "would be considerably below those of taxpayer which operated an underground mine." (R. 68, 89, 136, 159) The strip miners sold their fire clay at prices varying from approximately $1.60 per ton to $1.90 per ton delivered in the Brazil area (R. 80, 90, 149-50, 158) and shale was sold for $1.00 per ton (R. 154), as compared with taxpayer's cost (without the allocation of any overhead) of $2.418 per ton to mine the fire clay and shale and deliver it 1.5 miles to its plant. (R. 39, 54; Gov't Ex. C, R. 56, 244) The testimony showed that the cost of transporting clay from Cannelton to Brazil, a distance of 140 miles, varied from a low of $4.58 per ton by rail (R. 37), to $5.50 per ton or more by truck. (R. 97; see R. 161)

On its original return for its fiscal year 1951, filed on February 11, 1952, taxpayer claimed no deduction for depletion. (R. 103)[2] Taxpayer filed an amended

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[1] The Government's Statement (Br. 4) says that "Substantial amounts of shale were also produced and sold in Indiana (R. 209), as well as in the United States generally." The Record citation contains no reference at all to sales of shale. The Record shows only two sellers of shale at Brazil, Indiana, both of whom were coal strip miners. (R. 82-83, 152)

We might also point out that the Bureau of Mines statistics as to sales of fire clay and shale, on which the Government relies in its Statement (Br. 4), are not in the Record.

[2] At that time, percentage depletion for fire clay and shale was not allowed, under the Internal Revenue Code, as to fiscal years ending in 1951. Revenue Act of 1951, § 319(c), 65 STAT. 497. By

return on August 15, 1952. (R. 249, 259) Before doing so, taxpayer was advised informally by the Chief of the Natural Resources Section of the Internal Revenue Service to compute its depletion deduction by using the selling price of its 80 tons of ground fire clay and shale and applying that price to its entire production. (R. 109-10) Upon audit of the taxpayer's return, it was allowed a deduction computed on the basis of including the costs and proportionate profits allocated to the processes applied through grinding and up to the pugmill and of excluding the costs and proportionate profits allocated to subsequent processes. (R. 95, 110-11)

Taxpayer in this suit claimed that its depletion deduction should be computed on the basis of the net sales of its burnt clay products, since they are its first commercially marketable mineral products. It also contended, in the alternative, that, if it was not entitled to compute its depletion deduction on such basis, it was entitled to compute its deduction on the basis of the actual selling price of the 80 tons of the ground fire clay and shale it actually sold. (R. 257)

The District Court found that there was no market for the fire clay and shale mined by taxpayer before it was processed into burnt clay products, except for negligible amounts of ground fire clay and shale sold in bags (Fdg. 12; R. 5), and held that taxpayer is entitled to compute its depletion deduction on the basis of the net sales of its burnt clay products. (Conc. 4; R. 6) The Court of Appeals affirmed. (R. 275)

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an amendment passed on July 21, 1952 (Pub. L. 594, 82d Cong., 2d Sess., § 5, 66 STAT. 820), it was allowed as of January 1, 1951, for such fiscal years.

SUMMARY OF ARGUMENT

Introduction

Section 114(b)(4)(A) of the Internal Revenue Code of 1939 provides that the depletion allowance, in the case of designated mines and other natural deposits, shall be a specified percentage of "the gross income from the property." Prior to 1943 the statute did not define "gross income from the property," and in administering the statute the Treasury began to try to restrict the depletion base in the same manner and for the same reasons as the Government now urges in this case. In order to prevent this, and over the Treasury's opposition, Congress in 1943 added to the Code, as Section 114(b)(4)(B), a definition of "gross income from the property." This definition provides that the term "gross income from the property" means the "gross income from mining" and that "mining" shall be considered to include "not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." It is the meaning of this definition which is at issue in this case.

The Government does not challenge the determination of the courts below that there was no market economically available for the taxpayer's fire clay and shale before it was processed into sewer pipe and other burnt clay products. Nevertheless, presenting an issue not raised at the trial, the Government contends that the taxpayer's raw fire clay and shale were the

"commercially marketable" products because they were "fit for commercial or industrial use." It argues that the taxpayer's depletion allowance for its fire clay and shale (which it obtained by costly underground mining and which yielded the best sewer pipe made in Indiana) should in some way be determined with reference to raw fire clay and shale, which were sold as by-products by coal strip miners 140 miles away.

In urging this result, the Government asks this Court to overturn decisions in 54 cases by the lower Federal courts, including several Courts of Appeals, the Tax Court, and numerous District Courts. A chart summarizing the cases is included as Part E of Respondent's Appendix II, pp. 173-81.

I

The case raised by the Government in this Court is not available to it on this Record. This case started out in the District Court as a very simple case. One of the issues raised by the pleadings, the pre-trial order, the opening statement of Government counsel at the trial, and the Government's brief—the only question relevant to the case at this stage—was whether there was a market economically available to the taxpayer for its fire clay and shale.

The taxpayer proved overwhelmingly that, whether there is a market for fire clay and shale elsewhere or not, the taxpayer's fire clay and shale were not "commercially marketable" because they could not economically be brought to any such market for sale. Indeed, it developed at the trial that the Government's case was apparently largely based on an error, a misplaced decimal point.

The Government now concedes "that taxpayer's mining and transportation costs were so high that it could not profitably market the minerals in crude form." (Gov't Br. 6; see also Gov't Br. 21, middle of the page.) The Government now raises a wholly different issue, never raised at the trial. It takes what may be called a "national market" approach, and uses such phrases as "basic product sold by the particular mining industry" (Pet. for Cert. 15) and "fit for commercial or industrial use." (Br. 21, 85, and elsewhere.) The Record contains no evidence about these things. No such issues were raised in the District Court. If such issues had been raised they would have involved the production of voluminous evidence, and the factual material now available to the Court would be entirely different. The question which the Government now raises cannot fairly be decided, and should not be decided, on this Record, made on another issue.

What the Government is, in effect, asking here is for a new trial. But it is not entitled to a new trial unless the District Judge erred in deciding the issues which the Government presented to him at the trial which has been held. The Government has had its day in court.

In default of a Record supporting the issues it now raises, the Government here relies almost entirely on "Official Statistics" which were never presented to the District Court, were not offered in evidence in the District Court, and are not included in the Record in this case. If the Court can take judicial notice of these reports, it can also take judicial notice of the way in which they are prepared, and of the inadequa-

cies and inaccuracies which are inherent in such material. They are surely a shaky foundation on which to rest the decision of a case involving "close to a billion dollars," which the Government now says this case is.

The findings made by the District Court on the evidence and issues presented to it are not now contested by the Government. That should be an end of this case. On this Record, as made on the issue presented by Government counsel, the judgment below should be affirmed without consideration by the Court of the new arguments now presented by the Government which were never presented to the District Court. In the alternative, the writ of certiorari should be dismissed. *Rice* v. *Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70, 77-79 (1955); *Tyrrell* v. *District of Columbia*, 243 U.S. 1 (1917).

II

The meaning of the statute necessarily turns upon the meaning of "the commercially marketable mineral product or products," since the "ordinary treatment processes" included in the statutory definition of mining are those "normally applied" by mine operators *in order to obtain* "the commercially marketable mineral product or products."

A. In order for a product to be "commercially marketable" within the ordinary meaning of that term, there must be an actual, continuing, regular opportunity to sell it on a practical business basis. In all the cases the courts have held that Congress intended the term to have its ordinary meaning.

The Government tries to write "commercially marketable" out of the statute by substituting for it, "fit for commercial or industrial use," a phrase that has a quite different meaning. Its position is that the other language of the statute shows a Congressional intent to exclude from "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products" any process which is "manufacturing" as the Government defines that term. The statute provides no basis for such an interpretation. If Congress had intended to exclude processes which might be called "manufacturing," it could have said so; as a matter of fact, however, nowhere in the statute did it use the word "manufacturing." Furthermore, Congress specifically listed in the statute as "ordinary treatment processes" certain processes (*e.g.*, cyanidation, leaching) which are "manufacturing" within the Government's definition of that term. Congress obviously intended to adopt a practical rule for computing percentage depletion based on using the selling price of the "commercially marketable mineral product or products," whether or not such product or products might be termed "manufactured."

B. The wording and structure of the statute show that "the commercially marketable mineral product or products" refers to the first product or products actually obtained by the taxpayer in his processing of his mineral which he has an opportunity to sell on a commercial basis. Section 114(b)(4)(B) defines "gross income from the property," which obviously refers to the particular taxpayer's gross income

from his mining operations. These are defined specially to include not merely the extraction by the taxpayer of its fire clay and shale from the ground but also certain processes applied "in order to obtain the commercially marketable mineral product or products." The plural reference to "products" shows that Congress did *not* intend to establish arbitrarily a single "basic product" for each mineral, as the Government contends.

Congress' intention that "the commercially marketable mineral product or products" may be different for miners of the same mineral is also shown by the lists of ordinary treatment processes in the statute. In the case of certain minerals and ores, the statute lists processes which are not always applied to such minerals; when applied, they yield products different from those sold in substantial amounts by other miners of the same minerals who do not apply them.

Further evidence of Congress' intent is found in its choice of the words, "commercially marketable." The determination of commercial marketability required by the statute is not one which can be made satisfactorily on an industry-wide basis for each class of minerals. In applying the statute to varied factual situations in the complex field of mining, the courts have had to deal with the geologic fact that there are different grades of the same mineral with different utility and value and with the economic fact that the market situation for mineral products varies materially. They have recognized that the determination of the commercially marketable mineral product or products must be made on the basis of such facts in order to carry out the Congressional purpose and that therefore there is not nec-

essarily a single commercially marketable product for each class of mineral.

Under the interpretation of the statute adopted by the court below and by the courts in all the many cases involving the question, the identity of "the commercially marketable mineral product or products" is a question of fact to be resolved by determining the first such product or products actually obtained by the taxpayer. Once that determination is made, then the processes which the taxpayer actually applies and which are the "ordinary treatment processes normally applied by mine owners or operators" in order to obtain such product or products are to be considered a part of mining.

C. The Government does not challenge the District Court's finding, endorsed by the Court of Appeals, that there was no market in which the taxpayer could have sold its fire clay and shale on a profitable basis, before it was processed into sewer pipe and other burnt clay products. These, then, were the taxpayer's commercially marketable mineral products.

The District Court also found that all of the processes applied by the taxpayer were the processes normally applied by mine owners or operators to obtain such burnt clay products. This finding is not challenged by the Government.

Therefore, the taxpayer is entitled under the statute to compute its deduction for depletion of its deposits of fire clay and shale on the basis of the selling price of its burnt clay products.

D. Even if the commercially marketable mineral product or produets are to be determined on an

industry-wide basis, as the Government contends, the judgment should be affirmed, since miners of fire clay and shale normally are required to process such minerals into burnt clay products to make them marketable.

If Congress has established an industry-wide test, then "mining" includes the processes "normally applied" by owners or operators of fire clay and shale mines in order to obtain commercially marketable products. What they "normally" do must be what they do usually and ordinarily. Because the Government agreed with the taxpayer at the trial that the issue was whether the *taxpayer's* clay was commercially marketable, there is no evidence in the record to show what processes producers of fire clay and shale in the country as a whole normally and ordinarily apply to obtain their commercially marketable products. However, as the Court of Appeals concluded, the record does show that in Indiana, where the taxpayer's mine is located, "the integrated miner-manufacturer was the rule rather than the exception" in 1951.

The statistics quoted in the Government's brief, as well as the findings in other cases where the Government did raise the issue, show that the same was true in the country as a whole.

III

Although the Government devotes most of its brief (pp. 9-17, 35-80) to an attempt to show that the legislative history of percentage depletion requires its interpretation of the statute, the fact is that the legislative history shows that: (1) Congress intended to

adopt the commercially marketable products rule, although recognizing that various miners of the same ore or mineral might thereby have different bases for depletion; and (2) Congress, in enacting and adhering to that rule, has repeatedly rejected the Government's position here and its arguments in support thereof.

Ever since Congress first enacted discovery value depletion in the Revenue Act of 1918, it has allowed a depletion deduction greater than a taxpayer's actual investment or cost in his mineral deposit, in order to provide an incentive to discover, develop, and operate deposits of natural resources. Percentage depletion, which has replaced discovery value depletion, allows a deduction bearing little or no relation to investment. Although the Treasury has long fought percentage depletion as over-generous and has repeatedly attacked the commercially marketable products rule, Congress favors percentage depletion and has repeatedly refused to accede to the Treasury's wishes.

A. Percentage depletion provides an easily computed deduction, once the dollar base (to which the applicable percentage is applied) has been determined. Congress has elected to use the commercially marketable products rule as a simple method to determine that base: the taxpayer can readily determine the selling price of such products (if he sells them) or their established market value (if he processes them further). In looking for a way to avoid the difficulties of valuation inherent in discovery value depletion, Congress chose this simple rule in preference to others which would have given a greater equality of treatment to miners of the same mineral.

B. Section 114(b)(4)(B), which specifically enacts the commercially marketable products rule and which is the provision to be interpreted in this case, was added to the Code by the Revenue Act of 1943. The Report of the Finance Committee, which added this provision to the Bill, makes its meaning clear, stating that it is intended "to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation." This Report also states that it "expresses the congressional intent of these provisions as first included in the law," and is "in accord with the original regulations and the Bureau practices and procedures thereunder." Consequently, to understand fully this legislative history, it is necessary to review the history of the Revenue Act of 1932 and the original interpretation of the depletion provisions of that Act.

In 1932, Congress granted percentage depletion to coal, sulfur, and metal mines. Guidance as to Congress' intent is supplied by the so-called "Shepherd Report" which, in 1929, proposed percentage depletion for metal mines on the basis that Congress adopted in 1932; this Report reviewed the market situation as to the various ores and recommended defining "gross income from the property" with reference to marketability. Before the Treasury released its regulations under the 1932 Act, the mining industry pointed out that they did not express the Congressional intent. The Treasury admitted that they did not, but, since the regulations were printed, they were released with the understanding that they would *not* be applied as writ-

ten, but would instead be applied to give effect to the commercially marketable products rule. In so applying them, however, the Treasury did not treat all producers of an ore in the same way; for example, a miner of gold ore who used cyanidation (an allowed process) or a miner of copper ore who used leaching (also allowed) was permitted to compute his allowance on a more refined product than miners who used smelting (a disallowed process; ores to be smelted are commercially marketable in the concentrate form before smelting).

About 1940, the Treasury changed its position and disallowed certain processes, apparently making the same theoretical distinction between "mining" and "manufacturing" as it urges here. Thus, it wanted to exclude metallurgical processes effecting a chemical change which altered the character of the mineral and feared that allowing some such processes (as it had been doing) would permit all "finished" products, such as steel, to be used to determine the depletion base; it justified its position on the ground of achieving equality and theorized that a mine owner who used these metallurgical processes supplied his own market for the ore.

When the Treasury's change in policy was called to Congress' attention in 1942, it did not act because the Treasury stated that it would correct the situation administratively. However, it did not do so, and Congress, in the Revenue Act of 1943, added Section 114 (b)(4)(B) to the Code, using the language to be interpreted here, which has no counterpart in any prior statute, regulation, or ruling. It also specifically listed

in the statute the metallurgical processes (including cyanidation and leaching) which the Treasury began to disallow in 1940. Thus, Congress clearly adopted the commercially marketable products rule which it had originally intended and which the Treasury had originally applied under its regulations.

C. Beginning in 1942, Congress granted percentage depletion to additional minerals and, finally, in 1954, granted it to all minerals. The legislative history shows that Congress, in so doing, has intended to provide an incentive to discover and develop deposits of these various minerals and has recognized that it is not just providing a return of the mine owner's capital. It is also obvious that Congress has adhered to the commercially marketable products rule, in the face of the Treasury's repeated attacks on it.

1. In 1950, Congress added to "mining" transportation from the point of extraction to the mill or plant where the ordinary treatment processes are applied, in order to insure the statutory scheme of using the selling price of the commercially marketable products as the depletion base. The Treasury at the time was trying to whittle away at that base by disallowing transportation after having previously allowed it.

2. Fire clay and shale were granted percentage depletion by the Revenue Act of 1951. The Government cannot point to any statement in the legislative history showing that Congress did not intend the depletion deduction for these minerals to be computed under the commercially marketable products rule, just as it is computed for all other minerals. A subsequent letter by Senator George, Chairman of the Finance Commit-

tee in 1951, written with reference to "brick and tile clay" (which was also granted percentage depletion in 1951) states that " . . . [T]he statute defining mining for purposes of computing depletion allowance for federal income and excess profits tax purposes does not exclude manufacturing processes so long as they are ordinary processes normally and necessarily used in obtaining commercially marketable mineral products," and that the Finance Committee was told that "manufacturing" processes would be included in "mining" as to that mineral.

3. In 1954, Congress at the request of industry representatives amplified the ordinary treatment processes specifically listed in the statute by adding certain processes for talc, magnesite, phosphate rock, and coal. On the other hand, when the Treasury sought legislation, in 1954, to exclude specifically the "manufacturing" processes applied to brick and tile clay, Congress refused to enact such legislation.

4. In 1958, the Treasury asked Congress to change the commercially marketable products rule by specifically excluding the "manufacturing" processes applied to clay and to the minerals used for cement. Congress took no action on this proposal.

5. In 1959, the Treasury asked Congress to abolish the commercially marketable products rule completely and to substitute a rule based on its distinction between "mining" and "manufacturing." The Ways and Means Committee held five days of hearings on this proposal. At these hearings, the Treasury made the same arguments as it makes here: it urged that only "mining" processes as opposed to "manufacturing"

processes should be allowed in determining the depletion base; it argued that the statute creates discrimination among taxpayers (accepting the interpretation that different taxpayers have different commercially marketable products) and encourages integration; and it stated that the present statute gives "excessive" allowances, presenting the same charts purporting to show the amounts of revenue involved as it attached to its Petition for Certiorari here.

The Treasury's proposal was received with a general lack of enthusiasm. One member of the committee feared that departure from the established commercially marketable products rule might develop "more confusion" and cause "a great deal of litigation over this cut-off point," instead of "bringing about uniformity of treatment." Another expressed the thought that "we might advisedly retain something that gives us an element of certainty rather than adopt the terrific uncertainty that we would find from the approval of a new approach to this question." It was also feared that, because of its uncertainties, the proposal would put too much power in the hands of the Treasury.

No further action was taken on the Treasury's proposal.

D. In summary, Congress has consistently used the commercially marketable products rule to supply the base for computing percentage depletion and has, in fact, always regarded it as central to its concept of percentage depletion. Congress enacted Section 114 (b)(4)(B), because the Treasury was departing from this rule. Ever since enacting that section, Congress has steadfastly adhered to the commercially market-

able products rule in spite of the Treasury's attacks on it, specifically including "transportation" in "mining" in 1950 to preserve that rule, and refusing to change the rule when the Treasury asked it to do so in 1954, 1958, and 1959.

IV

A. The Government's position here that income from "manufacturing" processes cannot be included in computing the depletion base is not new. When the Treasury first adopted such position, Congress negatived it by enacting Section 114(b)(4)(B). The Treasury revived it in 1953, by an amendment to its regulations. This amendment was promptly challenged in court and the Government tried to square its position with the statutory language by arguing that "commercially marketable" means "ready for manufacture." As it lost case after case, it turned to other words in the statute to justify its interpretation, emphasizing at various times the word "mineral" which appears before "product or products" and "normally applied by mine owners or operators." Now, after having been unsuccessful with all these arguments in the lower courts, it returns to the position that "commercially marketable" means "fit for commercial or industrial use," although it did not so argue in the courts below or in its Petition for Certiorari.

The Government's difficulty and vacillation in attempting to square its basic position (distinguishing "mining" from "manufacturing") with the statute shows it is trying to read into the statute something which is not there.

B. The weakness of the Government's case is shown by its failure to take a position in its brief as to how the statute should be applied to this taxpayer; it merely says (Br. 80, Heading III) that taxpayer's deduction must be computed "with reference to" raw fire clay and shale, and asks (Br. 91) that this Court reverse and remand so that the taxpayer's "'gross income from mining' may be determined in the light of the correct legal criteria."

Under the Treasury regulation, either a "market or field price" or "proportionate profits" method would be used.

Any use of a "market or field price" presents many unanswered questions. Is the price determined for a "local" area (even though there is no area in which taxpayer could sell its fire clay and shale on any practical, business basis) or for the country as a whole? As of what date is the price computed? For fire clay, is it an average price for all kinds of fire clay, which vary widely in utility and value? Are the prices of fire clay and shale sold as by-products by coal strip miners relevant in determining the depletion deduction of producers of fire clay and shale from underground mines?

In the District Court, the Government discarded the "proportionate profits" method, describing it as "abrogated" and "abandoned," and its brief does not assert that it should be used in this case.

C. Application of the Government's theories to other factual situations would cause confusion and illogical results.

For example, there are situations (involved in decided cases) where two commercially marketable products are obtained by entirely different processing from the same deposit of the same mineral, not marketable in crude form, and where one of those products is more valuable because of the greater value of the raw mineral used to produce it. How would "gross income from mining" be computed in the case of the mineral used for that more expensive product? Under the Government's approach, it would seem that the taxpayer's deduction might well be smaller in the case of the mineral used for the more valuable product, because only the processes applied to obtain the cheaper product (the "basic" product) would be included in "mining" and thus none of the processes applied to obtain the more expensive one would be so included. If, as it has in some cases, the Government should say that the depletion base for the more valuable product is the market price of the cheaper product, there would be problems of applying the statutory limitation of the deduction to 50% of the "net income of the taxpayer . . . from the property." If a miner of such a mineral produced only the more valuable product, how would he compute the "net income" that he *would* have realized *if* he had applied the entirely different processes that others use to obtain the "basic" product and thus had incurred entirely different costs?

Furthermore, how would the basic mineral product be determined for minerals such as brick and tile clay for which there is no market anywhere before "manufacturing" processes are applied? When are such minerals "fit for commercial or industrial use"? The

Government says here (Br. 18) that a market somewhere in the country provides "conclusive proof" that a mineral has reached this stage, but recognizes that other tests will be needed when there is no such market. If the first process after extraction is not allowed, there are no "ordinary treatment processes"; if it is included, there is no logical or reasonable basis for saying industrial use begins with any succeeding process.

Any explanation of how to compute the deduction in these situations will of necessity involve arbitrary distinctions and theoretical computations which will produce results inconsistent with the legislative intent.

D. The Government urges this Court to consider what it calls the "extreme results" of the commercially marketable products rule.

The Government claims the rule results in "sharp disparities and widespread discrimination" between the "integrated miner" and others, but the illustrations which it gives do not show results inconsistent with the intention of Congress. For example, it points to a contractor (described by the Government as a "non-integrated miner in the same area") who extracted and hauled clay and shale for the mine owner at a rate per ton for his services. The Government says this contractor was entitled to a depletion allowance of only 15 cents per ton. Actually he was not entitled to any depletion allowance, since he had no economic interest in the clay and shale deposits.

The Government's assertion that the holding below encourages "vertical integration" on an "inefficient basis" assumes without justification that the taxpayer's mine was inefficient. The statute as written may well encourage the development of mines which otherwise

would not be developed—just as Congress intended. Whether it will lead to the merger of existing business entities is a complicated economic question as to which assumptions are unreliable. Any such possibility has not alarmed Congress, which has rejected the Treasury's pleas to eliminate the commercially marketable products rule.

The Government's claims as to "virtually limitless" possibilities for depletion allowances and "enormous" potential impact upon the revenue under the commercially marketable products rule are unsupported. The applicability of the rule depends entirely on the factual question of commercial marketability. In its predictions, the Government assumes that various minerals cannot be sold commercially until they are processed into "manufactured products," without analyzing the facts so that this Court may consider whether such assumptions have any foundation under the statute as construed by the courts.

The Government's complaint about the administrative problems under the commercially marketable products rule exaggerates the difficulties, ignores the administrative problems which would result from the Government's theory, and simply reflects the Treasury's desire for restoration of the broad administrative discretion in determining "gross income from the property" which Congress took away in enacting the statutory definition of that term.

In sum and substance, the Government now asks this Court to do what Congress has steadfastly refused to do, and this is an area which is peculiarly one for legislative judgment.

ARGUMENT

Introduction

The Government argues that the decision of the Court of Appeals should be reversed because "two fundamental and closely related propositions" which it adopted are erroneous.[1] By so arguing, the Government asks this Court to overrule decisions in 54 cases, decided by a total of 52 Federal judges (25 Court of Appeals judges, 26 District Court judges, and 4 Tax Court judges), over a period of 16 years.[2] In this lengthy and extensive litigation, the Government has obtained only one decision supporting its position here; and that was by a District Judge, who was reversed by the Court of Appeals, and who based his decision on grounds which the Government does not even present in its brief. *The Government does not, and cannot, cite one decision to support its position here.*

Furthermore, the Government asks this Court to overrule these cases after repeated, unsuccessful attempts to have Congress change the statutory provisions so as to adopt the Government's position here. In 1954, it tried unsuccessfully to obtain an amend-

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[1] These propositions are stated as follows (Gov't Br. 21-22):

"(1) that the product with reference to which the gross income from mining is computed varies according to the particular product which the taxpayer, on the basis of his particular operation, finds it profitable to sell; (2) that the phrase 'ordinary treatment processes normally applied by mine owners or operators' may be extended to take in processes which could never be employed by one who is strictly a mine operator and can only be utilized by one who is also a manufacturer."

[2] A complete list of these cases, together with the names of the judges who decided them, is set forth in Part E of our Appendix II, pp. 173-81.

ment enacting its position as to brick and tile clay; in 1958, it tried unsuccessfully to obtain an amendment enacting its position as to clay and as to minerals used for cement. In 1959, it submitted a broader legislative proposal covering all minerals and completely eliminating the "commercially marketable mineral product or products" test of the present statute. The Ways and Means Committee held five days of hearings, but has not reported a bill.

Thus, the Government is now urging this Court to upset an unusually long and unanimous line of authority, after three unsuccessful attempts to obtain legislation. In so doing, it presents to this Court a synthesis of most of its arguments which the lower courts have unanimously rejected, relying on (1) the statutory language and (2) the legislative history, but without ever explaining how it believes the depletion deduction should be computed in this or other cases. As we shall show below, the statutory language and legislative history have been correctly interpreted by the many lower courts which have carefully and repeatedly considered them.

I

THE CASE RAISED BY THE GOVERNMENT IN THIS COURT IS NOT AVAILABLE TO IT ON THIS RECORD

This case started out in the District Court as a very simple case, involving two factual issues. These were:

1. Whether the taxpayer's clay was fire clay; and
2. Whether there was a market which was economically available to the taxpayer.

Both the taxpayer and the Government tried the case on this basis. The taxpayer presented only three witnesses, two officers of the company in person, and one expert by deposition. Through this evidence, it proved overwhelmingly that its clay is fire clay. The District Court so found, and the Government did not appeal from that decision. That question, to which much of the Record is devoted, is no longer in the case.

In addition, the taxpayer proved overwhelmingly that, whether there is a market for shale or fire clay in Brazil, Indiana, or not, the taxpayer's shale and fire clay were not "commercially marketable" in Brazil, because they could not economically be brought there for sale. The prices shown by the Government's evidence for sales in Brazil range from $1.00 per ton for shale (R. 154) to approximately $1.60 to $1.90 per ton for some types of clay. (R. 80, 90, 149-50, 158) The evidence clearly showed that the taxpayer's cost of extracting its shale and clay from the ground in 1951 was $2.418 a ton (R. 39), and that the cost of transportation to Brazil varied from a low of $4.58 per ton by rail (R. 37) to $5.50 or more per ton by truck. (R. 97; see R. 161) On this basis, the District Court rejected the Government's contention that the taxpayer's shale and clay were commercially marketable in Brazil, or anywhere.

Indeed, at the trial it developed that the Government's whole case was apparently based on a misplaced decimal point. In his opening statement, counsel for the Government stated (R. 17) that:

"The economics of the situation will also be a matter of proof and the Government will offer evidence to show the average cost, including a profit, of transporting clay is 1.8 cents per ton mile. The Government will further demonstrate at that price, comparing with the price that was paid by the taxpayer to haul clay, they could haul clay considerable distances."

When the Government's witness, Charles N. Smith, appeared, he gave such testimony. He testified explicitly that the cost "would be about 1.8 cents." (R. 84) He held to this figure on cross examination (R. 85), but weakened towards the end. (R. 87) Then, on the following day, counsel for the Government stood up in court and said (R. 161):

"Mr. Smith, who testified yesterday, has examined the computations which he made, and states to me that he made a misplacement of the decimal point, and it should be 18 cents per ton mile, rather than 1.8 on the short-haul distances."

The Record then continues (R. 161):

"Mr. Travis: (For Pltf.) We will stipulate the 18 cents is correct, the correct figure.

"Mr. Friesen: (For Deft.) Mr. Smith came back to make the record clear."

It was also testified that this hauling cost did not include a profit, but was "strictly the cost." (R. 85)

On the case which the Government now raises, the cost of transportation between Cannelton and Brazil, or any place else, is utterly irrelevant. The Govern-

ment now concedes the only issue remaining which was in the case at the trial, for it expressly states "that taxpayer's mining and transportation costs were so high that it could not profitably market the minerals in crude form." (Govt. Br. 6; see also Gov't Br. 21, middle of the page.) The Government now raises a wholly different issue, never raised at the trial, namely, that there is a "basic product sold by the particular mining industry" (Pet. for Cert. 15), or that the depletion allowance is to be determined by "sales of fire clay on a national scale" (Gov't Br. 82), or by "national sales of shale." (Gov't Br. 83) Thus, the Government now takes what may be called a "national market" approach, and here contends that the taxpayer's depletion allowance should, in some way, be determined by this national market to which it concededly could get no access. This may not be exactly the Government's position now; but whatever it is, it is different from anything which was raised in or presented to the District Court.

The Record contains no evidence about "basic product sold by the particular mining industry," or about other aspects of the fire clay and shale industries on a national basis. It contains no evidence about the application of "fit for commercial or industrial use" (Gov't Br. 21, 85), or any other of the several phrases on which the Government now relies in its interpretation of the statute. No such issues were raised in the District Court. Neither of these terms was even mentioned by Government counsel in the District Court, either in pleadings, pre-trial conference, opening statement, at

the trial, or in argument or brief.[1] Yet, it is obvious that they are the keys to the contentions which the Government is now making.

If such issues had been raised, they would have involved the production of voluminous evidence. Evidence would have to be introduced to show not only the circumstances and conditions, and facts about sales, in Brazil, Indiana, but also at many other places in the United States, and perhaps elsewhere in the world. In addition, evidence would be introduced to show that types of clay and shale are not fungible, that there are many variations and differences in quality, consistency, chemical content, color, durability, heat resistance, and so on, in various clays, so that the mere fact that some fire clay or shale of some quality and character was sold some place would not mean that there was a "market" which was relevant to this particular taxpayer, whose special quality of clay and shale resulted in "the best sewer pipe that is made in Indiana." (R. 127)

If these issues of a "national market" or of "fit for commercial or industrial use" had been raised at the trial, the Record in this case and the factual material available to the Court would thus be entirely different. The question which the Government now

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[1] In its Reply Brief in the Court of Appeals below in this case, the Government expressly recognized this as to "national market." It said (p. 15): "But we had not heretofore thought it was necessary for the Court to decide the national versus area-wide marketability question in this case, *and accordingly did not argue it either in the trial court or in our main brief in this Court.*" (Italics ours.) Clearly the present position of the Government is an afterthought.

raises cannot fairly be decided, and should not be decided, on this Record, made on another issue. This case, as the Record clearly shows, is a simple case, presented to the District Court on simple factual issues. These issues related at most to a local market in Brazil, Indiana, and they were settled when it was shown that there was no market there which was relevant to this taxpayer, since the taxpayer could not get to it. That market, if it is a market in any appropriate sense, is no more relevant to this taxpayer than if it had been in Maine or in Hawaii. The economics of the situation kept the taxpayer's clay and shale out of Brazil as effectively as it kept it out of New York or Seattle. The Government did argue "market or field price," but the evidence shows that there was no "market or field price" for any sort of clay and shale in an area which included Cannelton. The case which the Government raised on these points, through pleadings, pretrial conference and order, opening statement, evidence and argument, was a fairly simple case, and was fully met by the taxpayer's evidence at the trial, and through cross-examination of the Government's witnesses.

The Government now raises a very complex case, involving complicated factual and economic issues on which the Government now says that "close to a billion dollars" turns. (Reply Brief on Pet. for Cert. 6) No such case was ever presented to the District Court. Would a billion dollar case be tried with three witnesses for the plaintiff, in two days?

Indeed, the Government concedes here, as it did in the court below (see note 1, p. 32 *supra*), that this Rec-

ord does not raise the questions it now wants decided. It does not ask for a reversal, with the taxpayer's complaint to be dismissed. On the contrary, its prayer (Gov't Br. 91) is that "the judgment of the Court of Appeals should be reversed and the cause remanded so the taxpayer's 'gross income from mining' may be determined in the light of the correct legal criteria." This, in effect, is a request for a new trial. But the Government is not entitled to a new trial unless the District Judge erred in deciding the issues which the Government presented to him at the trial which has been held. The District Judge made no such error on the issues and arguments which the Government tendered him. The Government has had its day in court. It is not entitled to another day in court in order that it may present a new and different case, based on issues which it never raised when this case was tried in the District Court.

The Government now, in default of a Record supporting the issues it now raises, relies almost entirely on "Official Statistics" which were not offered as evidence in the District Court, were never presented to the District Court, and are not included in the Record in this case. There are two such items, first, the "Minerals Yearbook" (1951), U. S. Bureau of Mines, Department of the Interior, and second, the "1954 Census of Mineral Industries," U. S. Bureau of the Census, Department of Commerce, both cited and relied on at pages 82 and 83 of the Government's brief.

This material, not in the Record, and never presented to the District Court, is surely a shaky foundation on which to rest the decision of a case involving "close

to a billion dollars." If the Court can take judicial notice of these reports, it can take judicial notice of the way in which they are prepared, which is by the distribution of questionnaires through the mail, often filled out by clerical or subordinate employees.[2] Many questions necessarily lurk in such a report. What, for example, is the definition of "fire clay"? The Record in this case shows that the meaning of that term is quite uncertain. Is it clear that all of those who responded to the questionnaires used the same meaning, or made the distinctions which are necessary if the data are to be useful in a case like this? What is the meaning of "sale" as used in these reports? Does it include sales between subsidiary and parent, or between divisions of the same company? How many of the sales were by strip miners or by miners who have underground mines? Is it clear that these two types of producers are in "the same industry"? Were the taxpayer's clay and shale usable for the same purposes for which the sales reported in these statistical reports were made? A market for materials with which the taxpayer's fire clay and shale are not reasonably interchangeable for the same purposes would not be relevant. Cf. *United States* v. *duPont & Co.*, 351 U. S. 377, at 394-5 (1956). The question of the extent to which materials and products are substantially fungible in this sense in the "national market" is clearly a question of fact, on which the factual presentation when the issue

[2] The Record does contain evidence that the reports obtained from the producers are compiled by a person who "is not geologically or ceramically trained." (R. 137). See also R. 83, showing the inadequate way the original reports are made.

is raised would clearly be extensive.[3] There is no evidence on this in this Record because no such issue was raised in the District Court.[4]

The issue in this case was originally raised by the following allegation in the complaint (R. 252) which was denied by the answer:

> "Except for negligible amounts, there is no market for the fire clay and shale mined by plaintiff before it is put in the form of vitrified sewer pipe."

No motion to dismiss was made for failure to state a cause of action on which relief could be granted.

A pre-trial conference was held on January 7, 1958, and, thereafter, a pre-trial order was entered which was approved by both counsel. This pre-trial order was never modified, and no request was made by the Government to modify it.

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[3] "No two clays are exactly alike; and it is seldom possible to substitute one clay for another in industry without considerable experimentation, even though extensive research data have been established." U. S. BUREAU OF MINES, DEP'T OF INTERIOR, BULL. No. 556, MINERAL FACTS AND PROBLEMS 187 (1956).

[4] The barrrenness of the Record on these issues now essential to the Government's case is shown by reference to the one paragraph in its Statement (Br. 4) which is devoted to the factual basis of its present contentions. There is there a reference to a Government Report which is not in the Record. Most of the other references are indirect references to this Report. One Record reference is contained in the following statement: "Substantial amounts of shale were also produced and sold in Indiana (R. 209) . . ." Reference to R. 209 shows that it contains nothing whatever about sales of shale.

Paragraphs II and IV of this pre-trial order are relevant, and appear at R. 264 and 265. They read as follows:

"II

"Counsel for the defendant represented to the court that the defendant, through its Internal Revenue Service, had initiated as of this date a survey regarding the sales of shale and fire clay in a certain marketing area which would include the location of the plaintiff's mine and factory, to determine whether or not the defendant will claim in this cause of action *that plaintiff has a market for the clay which it mines prior to being put in the form of finished vitrified sewer pipe* and other related products which are made and sold by the plaintiff; and further, that if the defendant determined that *there was such a market, then an additional survey would be made to determine the market value of the clay mined by plaintiff at the point where the defendant determined that there was a market for the clay.*

"Counsel for the defendant further represented that if it were determined as a result of the survey that there was no market for clay and shale of the type mined or used by plaintiff prior to its being put in finished form ready for sale, then plaintiff's claims as alleged in plaintiff's complaint would be recommended for administrative refund by the Internal Revenue Service of defendant.

. . .

"IV

"If this cause of action is to be tried by the court, it was agreed between the parties that the *only issues of fact* which would have to be presented to the court *would be first, whether the plaintiff has any 'commercially marketable product or products' from the shale and clay which it mines prior to the finished vitrified sewer pipe and other products* which plaintiff produces and sells; and, *second*, what is the value of such 'commercially marketable product or products' *if* it is determined that plaintiff has such a product or products prior to the completed vitrified sewer pipe and other products which plaintiff makes and sells." (Italics ours.)

That the issue in the case was the narrow one relating to this particular taxpayer was again made clear in the opening statement by the Government's counsel, where he said that the issue was (R. 16):

"What is the first commercially marketable mineral product of this particular mine owner's mine or operator's mine?"

After the trial of the case the District Court made its Findings of Fact in accordance with the issues framed by the pre-trial order. Findings 12 and 13 are as follows (R. 5):

"12. There was no market for the fire clay and shale mined by plaintiff before it was processed into said products, except for negligible amounts of fire clay and shale sold in bags.

"13. The first 'commercially marketable mineral product' of the fire clay and shale mined by plaintiff during the years in question was the said finished products."

These findings have never been attacked by the Government as not being sustained by the evidence.

The findings made by the District Court on the evidence and issues presented to it are not now contested by the Government. Thus, the Government now admits that the District Court correctly decided the issue as it was presented and tried by Government counsel.

That should be an end of this case. We submit that on this Record, as made on the issue presented by Government counsel, and since the Government has conceded that the only factual issues presented to the District Court were correctly decided, the judgment below should be affirmed, without consideration by this Court of the new arguments now presented by the Government which were never presented to the District Court.[5] In the alternative, the writ of certiorari should be dismissed as having been improvidently granted. See *Rice* v. *Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70, 77-79 (1955); *Tyrrell* v. *District of Columbia*, 243 U.S. 1 (1917).

In the *Tyrrell* case, certiorari was granted on the basis

[5] This question was fully presented to the Court of Appeals by the taxpayer in its brief in that court (pp. 17-24). The taxpayer has never waived its contention that the broad issues now raised—clearly involving substantial bases of fact not developed in this Record—were never raised at the trial in this case. The taxpayer should not be prejudiced because the Court of Appeals chose to put its decision on broader grounds.

of a petition which stated that the Court of Appeals ignored, or was under misapprehension about, a line of cases holding that the District of Columbia was responsible for torts of its employees. On examining the record, after oral argument, this Court found (243 U.S. at 4) "that the question upon which the certiorari was prayed . . . does not arise on the record and is not open for consideration." The Record showed that the trial court had charged the jury that the District could not be responsible for an isolated act of negligence, but if responsible at all was liable only for the maintenance of a nuisance. No exception was taken on the issue of an "isolated act of negligence." This Court dismissed the writ of certiorari, "since that question, under the state of the record, was not before the lower court and would not be open for our consideration. . . ." 243 U.S. at 6. See also *Furness, Withy & Co.* v. *Yang-Tsze Ins. Ass'n*, 242 U.S. 430 (1917).

Similarly here, the questions now raised by the Government but not presented at the trial, do not find a basis in the Record actually made in this case, and should not be considered here in this case.

II

THE STATUTORY LANGUAGE REQUIRES THE CONCLUSION REACHED BY THE COURTS BELOW THAT THE TAXPAYER IS ENTITLED TO COMPUTE ITS PERCENTAGE DEPLETION DEDUCTION ON THE SELLING PRICE OF THE BURNT CLAY PRODUCTS WHICH IT OBTAINED BY PROCESSING ITS FIRE CLAY AND SHALE.

Section 114(b)(4)(A)(i) and (iii) of the Internal Revenue Code of 1939 allowed the taxpayer a depletion

deduction of 5% of its "gross income from the property" in the case of its shale and 15% of its "gross income from the property" in the case of its fire clay, limited in each case to 50% of "the net income of the taxpayer (computed without allowance for depletion) from the property." Section 114(b)(4)(B) provides the definition of "gross income from the property" which applies in computing the taxpayer's percentage depletion deduction allowed by Section 114(b)(4)(A), and it is the meaning of this definition which is at issue in this case.

We agree with counsel for the Government (Br. 26-27) that the crucial language in this case is the following portion of the definition:

> "As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products . . . ."

However, in construing the statutory definition, which is set out in full in Appendix I (pp. 123-24 *infra*), all of the language should be considered and every effort should be made to interpret each portion of it in a reasonable way consistent with the reasonable meaning of other portions. In order to harmonize its restrictive interpretation of other language in the statute with the

key phrase, "commercially marketable mineral product or products," the Government is forced to give that term an artificial meaning which in effect writes it out of the statute. The Government asks the Court to substitute for "commercially marketable" the quite different term, "fit for commercial or industrial use." (Br. 18, 21, 25, 26, 76, 78, 80, 85, 90)

The meaning of "commercially marketable mineral product or products" is vitally important to interpretation of the statute in accordance with the Congressional intent. Although Government counsel stress the term "ordinary treatment processes," and refer to the words "normally applied. . . . to obtain the commercially marketable mineral product" as "the dependent clause" (Br. 18, 90), the meaning of the statute must necessarily turn upon the meaning of "commercially marketable mineral product or products." This is so because the "ordinary treatment processes" included in the statutory definition of mining are those "normally applied by mine owners or operators *in order to obtain the commercially marketable mineral product or products.*"

A. A "commercially marketable" product within the meaning of the statute is a product which can actually be sold commercially, as the courts below and many other courts have held, not merely a product "fit for commercial use" as contended by the Government.

1. The courts have properly interpreted "commercially marketable" in accordance with its ordinary meaning.

In order for a product to be "commercially marketable" within the ordinary meaning of that term, there

must be an actual, continuing, regular opportunity to sell it on a practical business basis.

In all of the cases involving the meaning of "the commercially marketable mineral product or products," the courts have recognized that the opportunity to sell a negligible quantity of a product does not make it "commercially marketable."[1]

As the courts have also agreed, "commercially marketable" is not a hypothetical or theoretical term. The mere fact that a product is theoretically usable for a certain purpose does not make it "commercially marketable"; there must be an actual, existing opportuntiy to sell it. As the Tax Court has said, to hold that a product is "commercially marketable" on the basis of theoretical usability, regardless of whether in fact it can be sold, "is to read the words 'commercially marketable' out of the statute."[2]

If the qualifying word, "commercially," is to be given any meaning, in order for a product to be commercially marketable it must be possible to sell it on a practical business basis. Unless it is economically feasible to sell the product, it is not commercially marketable. In *Commissioner* v. *Iowa Limestone Co.*, 269 F.2d 398, 403 (8th Cir. 1959), the Court of Appeals concluded that "the profit-making aspect must be given

[1] *E.g.*, Dragon Cement Co. v. United States, 244 F. 2d 513 (1st Cir. 1957), *cert. denied*, 355 U.S. 833 (1957); United States v. Merry Bros. Brick and Tile Co., 242 F.2d 708 (5th Cir. 1957), *cert. denied*, 355 U.S. 824 (1957); United States v. Sapulpa Brick and Tile Corp., 239 F.2d 694 (10th Cir. 1956); United States v. Cherokee Brick & Tile Co., 218 F.2d 424 (5th Cir. 1955).

[2] Riverton Lime and Stone Co., 28 T.C. 446, 452 (1957).

consideration in determining whether a mineral product is commercially marketable" and quoted with approval the following interpretation of "commercially marketable" in *Sparta Ceramic Co.* v. *United States*, 168 F. Supp. 401, 404 (N.D. Ohio 1958):[3]

> "Taxpayer equates 'commercially marketable' with 'economically feasible', and adopts the view that before a product is commercially marketable there must be the prospect of substantial sales with the possibility of a profit being made thereby.
>
> "The Government's theory on the definition of this term is that it means only salable or fit to be offered for sale in business intercourse.
>
> "Both logic and the decided cases support the taxpaper's interpretation.
>
> "Websters' New International Dictionary (2nd Ed.) defines 'commercial' as:
>
> "'1. Of or pertaining to commerce * * *
>
> "'2. Having financial profit as the primary aim.'
>
> "'Marketable' is defined as
>
> "'1. Fit to be offered for sale in a market; * * *
>
> "'2. Wanted by purchasers, saleable; * * *'
>
> "Thus, 'marketable' can be said to be 'saleable, or fit to be offered for sale in a market', which is exactly the definition the Government wishes to ascribe to 'commercially marketable'. The fallacy of this desired interpretation is the failure to include the profit making aspect, 'commercial'."

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[3] Now on appeal to the Sixth Circuit.

It is the concept of economic feasibility so expressed which the Court of Appeals had in mind in the instant case in holding that products (raw fire clay and shale) which the taxpayer "could not sell at a profit" were not commercially marketable. As the courts below recognized, a product is not commercially marketable unless a market for it is economically available. The Court of Appeals did not mean that an assured profit is essential to commercial marketability or, as the Government suggests (Br. 81), that Congress undertook by the depletion statute "to guarantee miners a profit."

In all of the cases which have arisen under this statute, the courts have treated "commercially marketable" as having its ordinary meaning and effect. As used in the statute, it refers to a product that can actually be sold on a commercial basis. So construed, as the court below said, its application is and has been treated by the courts as a question of fact. (R. 270)

2. *The Government's construction of "commercially marketable" is not a reasonable interpretation of the words used by Congress but an unwarranted substitution of quite different words.*

The Government gives some recognition to the ordinary meaning and effect of "commercially marketable" as a statutory standard by the following concession in its brief (p. 85):

> "If the words 'commercially marketable mineral product' stood alone in the statute and one ignored the purpose, history and related language, there might be some basis for suggesting that 'commercially marketable' means 'marketable by the individual seller at a profit'. . . ."

The Government then argues that the context of the phrase requires that it be interpreted as "the product fit for sale or commercial use." (Br. 85-86)

In essence the Government's argument as to the context of the phrase is that "ordinary treatment processes normally applied by mine owners or operators" must be interpreted as restricted to mining processes as distinguished from manufacturing processes. (Br. 7-9) [4] For the Government, it is not enough that processes necessary to obtain a commercially marketable mineral product are the ordinary processes normally applied by miners; although the statute does not say so, the Government contends that the processes must be "normal for miners, *qua* miners." (Br. 7-8)

The Government's argument in this case is the same

[4] It was not until 1953, almost 10 years after the statutory definition of "gross income from the property" was enacted by Congress in 1943, that the Treasury adopted a regulation interpreting that definition as intended to exclude processes of a manufacturing nature even though they are applied and required in order to obtain a commercially marketable mineral product. This regulation, added to Section 29.23(m)-1(f) of Treasury Regulation 111 by T.D. 6031, 1953-2 CUM. BULL. 120, is the italicized portion of that Section as reprinted in Appendix I, pp. 125-28 *infra*. In cases in which the Government has relied upon this regulation, it has been held invalid on the ground that the statutory definition of "gross income from mining" does not permit such an interpretation. *E.g.*, *Dragon Cement Co.* v. *United States*, 244 F.2d 513, 518, 520 (1st Cir. 1957), *cert. denied*, 355 U.S. 833 (1957); *Cherokee Brick & Tile Co.* v. *United States*, 122 F. Supp. 59, 63-64 (M.D. Ga. 1954), *aff'd*, 218 F. 2d 424 (5th Cir. 1955); *Sapulpa Brick and Tile Corp.* v. *United States*, 56-2 U.S.T.C. ¶ 9709 (N.D. Okla. 1956), *aff'd*, 239 F.2d 694 (10th Cir. 1956).

The Government's brief in this case makes no mention of the 1953 regulation, although it was the basis for the Revenue Service's computation of the taxpayer's percentage depletion deduction for the taxable year involved. R. 95-96, 110-11; see Rev. Rul. 54-109, 1954-1 CUM. BULL. 62 (Resp. App. II, p. 161).

argument in substance which it made in the *Dragon Cement Company* case and the *Merry Brothers Brick and Tile Company* line of cases,[5] in which it unsuccessfully petitioned this Court for a writ of certiorari to review decisions holding that the statutory definition of mining includes *all* "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products," even though such processes may be in the nature of manufacturing. In its petition for certiorari in the *Merry Brothers* group of cases (p. 16), the Government made its argument directly, as follows:

> ". . . Congress was primarily concerned not with the marketability of the mineral product, but with the nature of the processes which were to be considered 'mining' processes."

The Government insisted in its petition for certiorari in this case (p. 12) that the issue in *Merry Brothers* was "entirely distinct" from the issue presented in this case. In *Merry Brothers*, it was contended, the issue was what is included in the phrase "ordinary treatment processes," whereas the issue presented in this case is how to determine the identity of the "commercially marketable mineral product." Now, however, it states frankly in its brief (pp. 18-19, 88-91) that the issue in this case and the issue decided in *Merry Brothers* are "closely related," and it squarely attacks the legal approach adopted by the courts in *Merry Brothers* and like cases as erroneous. Having been unsuccessful in its previous attempts to persuade the courts to ignore

[5] See note 1, p. 43 *supra*.

completely the commercially marketable products rule, however, it now urges that the same result should be achieved by construing "commercially marketable" to mean "fit for commercial or industrial use." (Br. 18)

Under the construction of the statute which the Government finds it necessary to urge in support of its position in this case, a product might be considered "commercially marketable" even though it is not sold and could not be sold by any miner anywhere. In this respect, the Government has changed its theory somewhat from that stated in its petition for certiorari in this case. In the petition (pp. 14-15), it took the position that the "commercially marketable mineral product" is the basic (least processed) product *sold* by the particular branch of the mining industry. Now, however, it takes the position that the "commercially marketable mineral product" is the "basic mineral product fit for commercial use." (*E.g.*, Br. 26) "Sales are significant for purposes of applying the statute," it repeats in its brief (pp. 18, 85), "not because an ability to sell profitably is relevant, but only because sales may provide conclusive proof that a mineral product has reached a state where it is fit for commercial or industrial use—proof, in other words, that the mineral has passed beyond the point where it can be said to be undergoing the ordinary processes of 'mining.'" Obviously, the Government considers that other proof will suffice in the absence of sales; the Commissioner merely determines what processes he considers are mining—"those processes which a non-integrated miner would have to use." (Br. 87) In the Government's view, those processes make the mineral product "com-

mercially marketable" whether or not it can then be sold by the particular miner or any other miner, because it is then "fit for commercial or industrial use."

No language in the statutory definition of "mining" requires the utter disregard of "commercially marketable" for which the Government contends. Indeed, it would be strange to find any support for such a result in a definition which Congress placed in the statute "to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation . . . ."[6]

The Government asks this Court to substitute for "commercially marketable"—the carefully chosen words which Congress deliberately used for a clearly stated purpose—some quite different words which would not accomplish that purpose. In support of its argument that Congress meant "fit for commercial or industrial use" when it said "commercially marketable," the Government relies upon the term "ordinary treatment processes" and upon the listing in the statute of certain processes which that term shall include in the case of specified ores and minerals, and of certain processes which it shall not include in the case of specified ores. The Government does not contend that fire clay and shale are included among the minerals for which

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[6] S. Rep. No. 627, 78th Cong. 1st Sess. 23 (1943) (Gov't App. B., p. 210).

included or excluded processes are listed. In fact, it concedes that they are not. (Br. 6, 21) Moreover, the Government concedes that the listing of included processes is not "necessarily" all-inclusive even with respect to the listed minerals. (Br. 31 n.21)[7] However, it argues that the term "ordinary treatment processes" itself and the types of processes listed show that the treatment processes which are included within the statutory definition of "mining" are of a "definite and restricted kind" (Br. 34), which is the *same* for *all* classes of mines and minerals. This argument by the Government, based on its assignment of "particularized and technical meanings" to the terminology used in the statute (Br. 34) and on an attempted technical classification of the types of treatment processes listed in the statute, is unsound. There is no indication from the statutory language or legislative history that Congress contemplated that resort to such technical theories should be necessary to discover its intention in defining "gross income from the property." Furthermore, the Government's theories are unsound on a technical basis, as shown by the analysis and references

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[7] This concession is required. Section 3797(b) of the Internal Revenue Code of 1939 provides:

> "The terms 'includes' and 'including' when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined."

This section was referred to by the courts in *Townsend* v. *The Hitchcock Corp.*, 232 F.2d 444, 447 (4th Cir. 1956) and *Dragon Cement Co.* v. *United States*, 244 F.2d 513, 516 (1st Cir. 1957), *cert. denied*, 355 U.S. 833 (1957), in concluding that the enumeration of processes in the statute is in no way exclusive even as to the ores and minerals covered.

to technical authorities which we have set out in Part A of our separately bound Appendix II (p. 1) and will summarize here.

The Government argues that the "statutory scheme," both in its use of the phrase "ordinary treatment processes" and in its listing of particular processes "which satisfy that concept," is in "full accord" with "the mining industry's own view of the scope of mining," as expressed in technical treatises and trade journals. (Br. 8, 31) In this technical literature, says the Government, mining "is regarded as including certain ordinary preparatory processes employed after extraction of the mineral to separate the valuable constituent of the natural deposit from waste matter." (Br. 8-9, 31) Of course, to say that certain processes are regarded by the industry as included in mining is not to say that other processes essential to obtaining a marketable product are *not* so regarded by the industry. Trying to bridge this gap, the Government suggests (Br. 31-33, 86) that in the industry "treatment processes" means the same thing as "mineral dressing," a technical term which does relate to the separation of the valuable constituent from waste.

This attempted restriction of the intended meaning of "ordinary treatment processes" is unwarranted. In the first place, there is no basis for the Government's suggestion that in the mining industry "treatment" is merely a synonym for "mineral dressing." (Resp. App. II, pp. 1-2)[8] In the second place, the processes

[8] Indeed, the leading authority in the field of mineral dressing, relied upon in the Government's brief for its statement as to the meaning of "treatment" and other points, obviously does not con-

specifically listed in the statute as included in "ordinary treatment processes" include processes which do not involve separating the valuable constituent from waste matter. (Resp. App. II, pp. 2-3) The Government recognizes that the listing of such processes as "ordinary treatment processes" necessarily refutes any contention that Congress intended to restrict the term to mineral dressing involving separation of the valuable constituent from waste matter. Conceding that putting minerals in "shipping grade or form may require, in some instances, such preparatory processes as crushing, screening, or drying" (Gov't Br. 9, 33), the Government shifts to another classification theory.

This ultimate attempt by the Government to restrict the meaning of "ordinary treatment processes" by classification of the included processes listed in the statute is on the basis of a distinction between mining processes, which it says "do not destroy the physical and chemical identity of the minerals" (Br. 9), and manufacturing processes, which it says "involve the mechanical or chemical transformation of inorganic and organic substances into new products." (Br. 9) This attempted classification is also refuted by the processes listed in the statute as included in "ordinary treatment processes." Many of these processes involve changes in the physical or chemical identity of the material or both. (Resp. App. II, pp. 3-6)

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fine the term "treatment" to mineral dressing. In fact, he includes a description of the processing of common clay and fire clay into brick and tile under the heading "Treatment" in his discussion of "Clay." TAGGART, HANDBOOK OF MINERAL DRESSING, 3-13 through 3-15 (1945 ed.) (Resp. App. II, p. 170).

It is apparent from the language of the statute—both the definition of "mining" as including "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products" and the specification of processes included in and excluded from the term "ordinary treatment processes" for various kinds of minerals and ores (Resp. App. II, pp. 6-8)—that Congress was not trying to draw a line between mining and manufacturing based on the technical nature of the processes, and whether they would be classified as mining processes or manufacturing processes by experts, who are bound to disagree. Rather, Congress was concerned with the practical test of a commercially marketable mineral product and defined "mining" as including *all* "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products."

The Government's argument that the language of the statutory definition of "mining" shows a Congressional intent to exclude processes which might be classified technically as manufacturing, even though they are required in order to obtain a product for which there is actually a commercial market, has been advanced in numerous other cases. The argument has been rejected in all those cases by the courts, including four Courts of Appeals, all of which held that "commercially marketable" must be interpreted in accord-

ance with its ordinary meaning.[9] The carefully considered opinion rejecting the Government's argument in *Dragon Cement Co.* v. *United States*, 244 F.2d 513 (1st Cir. 1957), *cert. denied*, 355 U.S. 833 (1957), is set out in Respondent's Appendix II (p. 11). In that opinion, Judge Magruder stated that the Court was unable to perceive any ambiguity in the phrase, "commercially marketable mineral product or products," and observed that three other Courts of Appeals which had weighed the same arguments by the Government and construed this "critical statutory phrase" had held it to be "clear and unambiguous" in favor of the taxpayer's interpretation. (Resp. App. II, p. 23)

The statutory definition of "mining" would be meaningless and useless if it were construed as the Government asks. The Government contends that "commercially marketable mineral product or products" as used

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[9] United States v. Cherokee Brick & Tile Co., 218 F.2d 424 (5th Cir. 1955) (brick and tile clay); Townsend v. The Hitchcock Corp., 232 F.2d 444 (4th Cir. 1956) (talc); United States v. Sappa Brick and Tile Corp., 239 F.2d 694 (10th Cir. 1956) (brick and tile clay); Dragon Cement Co. v. United States, 244 F.2d 513 (1st Cir. 1957), *cert. denied*, 355 U.S. 833 (1957) (cement rock); United States v. Merry Bros. Brick and Tile Co., 242 F.2d 708 (5th Cir. 1957), *cert. denied*, 355 U.S. 824 (1957) (brick and tile clay).

"Commercially marketable" has also been interpreted in accordance with its ordinary meaning by two other Courts of Appeals to which the Government made a somewhat different argument—*i.e.*, the Courts of Appeals for the Seventh Circuit, in the instant case, and the Eighth Circuit, in *Commissioner* v. *Iowa Limestone Co.*, 269 F.2d 398 (8th Cir. 1959) (limestone). See also *New Idria Quicksilver Mining Co.* v. *Commissioner*, 144 F.2d 918 (9th Cir. 1944), discussed in Kent, *The New Idria Decision*, 30 MINING CONGRESS JOURNAL 27 (1944) (Gov't App. B, pp. 479-81).

in the statute refers to a mineral product which has reached "a state where it is fit for commercial or industrial use"; and the Government considers that such a state is reached once "the mineral has passed beyond the point where it can be said to be undergoing the ordinary processes of 'mining.'" (Br. 85)

If that were so, the statutory definition could be rewritten correctly as follows:

> The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain a mineral which has undergone the ordinary processes of "mining."

Or, in other words, "mining" shall be considered to include what the Commissioner considers "mining."

If the Government's interpretation were adopted, the special definition of "mining" which Congress placed in the statute would be rendered nugatory. The scope of "mining" under the statute would be left completely to regulation by the Treasury. This, of course, is the result greatly desired by the Treasury, which urged Congress not to add the definition to the statute in the first place on the ground that the subject should be covered by Treasury regulations.[10]

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[10] Senate Debate, 1942, 88 CONG. REC. 8033 (Gov't App. B, pp. 196-97).

B. The "commercially marketable mineral product or products" means the first product or products actually obtained from a mineral by the miner which he has an opportunity to sell on a commercial basis.

The wording and structure of the statute and the nature of the determination of commercial marketability required by the statute show that "the commercially marketable mineral product or products" refers to the first product or products actually obtained by the taxpayer in his processing of his mineral which he has an opportunity to sell on a commercial basis.

Section 114(b)(4)(A) provides that the depletion allowance, in the case of designated mines and other natural deposits, shall be a specified percentage "of the gross income from the property during the taxable year." As applied to this case, "gross income from the property" obviously refers to this particular taxpayer's "gross income from the property," and "the property" is the mine operated by this taxpayer.

Section 114(b)(4)(B) provides that "gross income from the property" means "the gross income from mining." As applied here, this refers to this taxpayer's gross income from its "mining" operations, which are defined specially to include not merely the extraction by the taxpayer of its fire clay and shale from the ground but also certain processes applied by the taxpayer in order to obtain "the commercially marketable mineral product or products."

The statutory definition of "mining" was provided for the purpose of computing the "gross income from the property" of individual taxpayers, and in applying it to compute the gross income from the property of a

particular taxpayer, it is necessary to determine first the identity of "the commercially marketable mineral product or products" in his case. The natural and ordinary way to apply this tax statute to a particular taxpayer is to determine what product or products the taxpayer first obtains in his line of processing of the mineral from his mine which he has an opportunity to sell on a commercial basis.

In contending that Congress has imposed an "industry-wide test" for the commercially marketable product (Gov't Br. 7, 27), the Government apparently relies upon the use of the terms "ordinary" and "normally" and the plural reference to "mine owners or operators." To be sure, these statutory terms impose restrictions, in that the treatment processes applied by the taxpayer to obtain the product or products which are his "commercially marketable mineral product or products" must be the ordinary treatment processes normally applied by mine owners or operators in order to obtain such product or products. In order to determine whether these restrictive provisions are met, reference must be made to the practices of other miners in obtaining such product or products. But this does not mean that Congress intended that a taxpayer's gross income from *his* property should be determined on the basis of the first commercially marketable product obtained by some other miner or miners of the same mineral. The taxpayer's gross income from the property must be determined on the basis of processes which he actually applies to obtain a product which he can market commercially, with the restriction that they must

be the ordinary processes normally applied by miners in order to obtain that product.

The Government argues that the statute does not permit each taxpayer to "include such processes as he may use in order to obtain the particular product which he markets." (Br. 27) We do not contend that the statute makes the selling price of any product a taxpayer may choose to sell the base for percentage depletion. As the Court below recognized (R. 273), the statute does not permit a taxpayer to compute percentage depletion on the selling price of a product processed beyond the stage at which it becomes commercially marketable. That is what the courts have meant in stating that the statute limits the depletion base to the *first* "commercially marketable mineral product." They have not meant that the statute contemplates a single "basic mineral product" for each "branch of the mining industry," as the Government would interpret it. (Br. 26, 76) Thus, in *United States* v. *Cherokee Brick & Tile Co.*, 218 F.2d 424, 425 (5th Cir. 1955), the court referred to "the commercially marketable mineral product" as "the first product which is marketable in commerce," but it allowed computation of percentage depletion for the taxpayer's brick and tile clay on the selling price of both the burnt brick and the burnt tile which the taxpayer produced from the clay.[11] In the case of each product, it was the first product obtained in the particular line of processing which was commercially marketable. This does not mean that under the view of the Courts of Appeals in

[11] See also cases discussed pp. 64-67 *infra*.

this and other cases "the possibilities for depletion allowances are virtually limitless," as the Government argues. (Br. 23) The same fear was expressed by the Government in *Commissioner* v. *Iowa Limestone Co.*, 269 F.2d 398 (8th Cir. 1959) and was answered by the court as follows (p. 405, Resp. App. II, p. 42):

> "The Commissioner expresses some fear that the logical result of the Tax Court's holding is that a miner can use as his depletion base the gross sale price of any product he chooses to manufacture. Such fear is without foundation. The depletion statute as interpreted by the Tax Court limits the depletion allowance to the first commercially marketable chemical grade limestone produced. . . . For depletion purposes the product may not be processed beyond the stage where it becomes a commercially marketable product. . . ."

The plural reference to "products" in the phrase, "the commercially marketable mineral product or products," shows that Congress did not intend to establish arbitrarily a single "basic product" for each mineral named in the statute. The Government claims that the plural reference to products is not inconsistent with its reading of the statute. (Br. 27) However, the Government's own explanation of Congress' use of the plural is inconsistent with its theory of interpretation. It describes the use of "products" as "merely a recognition of the fact that one mining operation (as in this case) may yield more than one mineral product (here fire clay and shale)." (Br. 27) Thus, the Government

has resorted to an explanation which inherently concedes that the statutory phrase, "the commercially marketable mineral product or products," refers to the "product or products" of a particular mining operation, not to a single, industry-wide "basic product" of the particular mineral. If Congress had used the phrase to refer to the basic product of each mineral on an industry-wide basis, there would have been no need to use the plural. There would be only one "commercially marketable mineral product" of fire clay and only one "commercially marketable mineral product" of shale, and the statute would be read separately for each.

It seems inconceivable that Congress would have used the plural reference to "products" for the reason suggested by the Government if its intention had been to fix "for each mineral an ascertainable and uniform cut-off point binding upon all miners" of that mineral. (Gov't Br. 9, 34) If that had been the intention of Congress, surely it would have avoided the use of a plural term which was unnecessary and which was inconsistent with that purpose.

The Government's explanation of the plural reference to products is not only inconsistent with its own theory but also attributes to Congress' use of the plural a limited and rather technical meaning which is out of harmony with the general language of the statutory definition.[12]

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[12] In attempting to support its explanation of the plural reference to products, the Government points out (Br. 27-28) that "a single ore frequently contains many different metals," and that this is

Further evidence of the Congressional intent is found in its choice of the words, "commercially marketable." The question of commercial marketability is not one which can be determined satisfactorily on an industry-wide basis for each class of minerals covered by the statute. Congress has undertaken to determine itself the stage at which certain ores become commercially marketable when treated by certain methods by specifying in the statute that the term "ordinary treatment processes" shall not include in the case of such ores "electrolytic deposition, roasting, thermal or electric smelting, or refining."[13] However, as Congress has recognized by *not* designating excluded processes for other classes of minerals, the question simply cannot always be determined satisfactorily on an industry-wide basis. In the case of many classes of minerals, including fire clay and shale, the first commercially marketable product will vary from area to area, or according to the grade of the mineral or the type of

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reflected in clause (iv) of Section 114(b)(4)(B), which refers to the "processes used in the separation or extraction of the product or products from the ore." As we shall show (pp. 62-63 *infra*; and Appendix II, pp. 10-11), the processes included by clause (iv) in "ordinary treatment processes" and those excluded from that term, show that Congress contemplated that there would be different commercially marketable products of ore processed for the same metal, depending upon the method used. Therefore, the plural reference to "products" in clause (iv) does not necessarily have the narrow meaning suggested by the Government.

[13] As the Government's brief states (p. 8), in the case of metallic ores, Congress "has excluded smelting and refining—processes which take place after the ore concentrate (saleable, at that stage, to smelters) has been obtained." See also Resp. App. II, pp. 6-8.

mine or the line of processing used. This is not to say that the question will be determined differently for every miner of a particular mineral. There is nothing peculiar or unique, for instance, about the mining of fire clay from an underground mine or at a distance from any markets for the raw fire clay and shale, which are the circumstances in this case which precluded the taxpayer from marketing the raw products on a commercial basis.[14]

Congress' recognition that "the commercially marketable mineral product or products" within the meaning of the statute may be different for miners of the same mineral is shown by the nature of certain processes which it has expressly listed in the statute as included in or excluded from "ordinary treatment processes." As shown in Part A of Respondent's Appendix II, certain processes included as "ordinary treatment processes" in the case of coal are applied to substantial amounts of coal in order to make it marketable but are not applied before sale to other substantial amounts of coal. (Resp. App. II, pp. 8-9) Furthermore, the statute expressly includes as "ordinary treatment processes" certain metallurgical processes yielding metallic gold or metallic copper, which are different and more processed products than the ore concentrate. Yet the ore concentrate is the commercially marketable product in the case of gold ore

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[14] See, *e.g.*, *Standard Clay Mfg. Co.* v. *United States*, 176 F. Supp. 590 (W.D. Pa. 1959), now on appeal to the Court of Appeals for the Third Circuit.

or copper ore which is smelted, as Congress recognized in excluding smelting from "ordinary treatment processes." (Resp. App. II, pp. 10-11)

The courts have also recognized that "the commercially marketable mineral product or products" within the meaning of the statute may be different for miners of the same mineral. In applying the statute to various factual situations in the complex field of mining, the courts have had to deal with the geologic fact that there are different grades of the same mineral and with the economic fact that the market situation for mineral products varies. They have recognized that the determination of "the commercially marketable mineral product or products" under a proper interpretation of the statute must be made on the basis of such facts and that there is not necessarily a single commercially marketable product for each class of mineral listed in the statute. They have considered this a necessary conclusion in order to carry out the Congressional purpose expressed in the phrase, "commercially marketable mineral product or products."

The viewpoint of the courts which have considered the matter was expressed by the Court of Appeals in its opinion in this case (R. 271) as follows:

> "We are unable to accept the theory that a taxpayer's depletion allowance is to be computed on the basis of a representative market or field price for a product which taxpayer could not sell at a profit. To do so would be to deprive of all meaning the words 'commercially marketable' as used in the Code provision here considered."

In *Townsend* v. *The Hitchcock Corp.*, 232 F. 2d 444 (4th Cir. 1956), the talc mined by the taxpayer was subjected to two distinct and separate processes. That which was suitable for the purpose was cut into crayons; the rest was pulverized. The pulverized talc was sold at a price which was only a small fraction of the selling price of the talc crayons. The trial court found that there was no commercial market for the talc until it was pulverized or cut into crayons, and that there were no sales of talc in its crude form as it comes from the mine anywhere in the United States except for a small percentage of the national output sold by itinerant miners on the West Coast. The Government argued that none of the processes applied by the taxpayer after extraction of the talc were includible in "mining." The Court of Appeals for the Fourth Circuit held that the taxpayer had two commercially marketable products, the pulverized talc and the talc crayons, and that the applicable percentage should be applied to the selling price of each product to compute the taxpayer's depletion deduction under Section 114 (b)(4) of the Internal Revenue Code of 1939.[15]

In *Commissioner* v. *Iowa Limestone Co.*,[16] the taxpayer quarried a relatively rare type of limestone suit-

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[15] For details as to the processing and relative value of the two products, see the record appendix to the Brief for Appellant, pp. 62, 115-16, 140, 184-87, *Townsend* v. *The Hitchcock Corp.*, 232 F. 2d 444 (4th Cir. 1956). In *International Talc Co.*, 15 T.C. 981 (1950), the Tax Court reached the same result as to pulverized talc, the only product processed by the taxpayer in that case.

[16] 269 F. 2d 398 (8th Cir. 1959), *affirming*, 28 T. C. 881 (1957). The opinion of the Court of Appeals is set out in Respondent's Appendix II, p. 28.

able for chemical use. It processed the stone by crushing and grinding it into a finely pulverized form, in which it was sold to feed and minerals manufacturers for approximately $9.00 per ton. These purchasers required that the stone be finely ground and that it meet rigid specifications as to chemical composition. The Commissioner contended that the first commercially marketable product of limestone, regardless of grade, is crushed limestone as sold for road or agricultural purposes for prices ranging from $1.35 to $1.75 per ton. Although the taxpayer's plant as constructed did not produce limestone satisfactorily crushed for road or agricultural purposes, it could have been converted to do such crushing. The Court of Appeals for the Eighth Circuit refused to accept the theory that there is a single commercially marketable product for all limestone, reasoning that "the profit-making aspect must be given consideration in determining whether a mineral product is commercially marketable," that the taxpayer "had the right to market its chemical grade limestone for the purpose for which it was most suited and in a field where it would command a fair price," and that it "was not economically feasible for the taxpayer to market its superior stone as ordinary road rock." [17]

Holding that the company's commercially marketable product was the pulverized chemical grade limestone which it sold, the court quoted with approval the Seventh Circuit's opinion in the instant case that Congress did not intend "that the depletion allowance for each mineral be reduced to the common denominator

[17] 269 F. 2d at 402-04 (Resp. App. II, pp. 38-39).

represented by a conceivable product most cheaply produced from each mineral."[18]

As in this case, the Government argued in the *Iowa Limestone* case that its single-product theory was necessary in order to avoid discrimination. The court's comment on this argument was as follows:

> "The Commissioner also argues that to give the taxpayer a greater depletion base than owners of inferior limestone quarries would be inequitable. At least as good an argument can be made that it would be unfair to the taxpayer not to allow it depletion based upon the reasonable consideration of the value of its depletable product. However, such arguments have no weight either way as the depletion base is controlled entirely by the statute. Any inequities call for legislative rather than judicial action."[19]

In *Albin C. Halquist*,[20] the Tax Court considered a similar question and reached the same result. The taxpayer in that case quarried dolomite, some of which it processed into dimension building stone and some of which it crushed for use as aggregate in construction and as agricultural stone. The stone sold as crushed stone came from a ledge which was not suitable for

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[18] 269 F.2d at 404 (Resp. App. II, p. 39). The Eighth Circuit has since followed the same reasoning in another case involving chemical grade limestone. *Bookwalter* v. *Centropolis Crusher Co.*, 272 F.2d 391 (8th Cir. 1959).

[19] 269 F.2d at 405 (Resp. App. II, p. 42).

[20] 33 T.C. 304 (1959). The opinion is reproduced in Respondent's Appendix II, p. 44.

dimension stone and from waste in the processing of dimension stone. The Commissioner contended that the single commercially marketable product for the dolomite and limestone industry is crushed stone, the crudest, least processed product marketed in more than negligible quantities, and that the taxpayer's depletion base for the stone processed into building stone was limited to the income that would have been derived if such stone had been sold as crushed stone. The Tax Court rejected this theory and held that the taxpayer was entitled to compute his percentage depletion allowance on the selling price of each of his products.

In addition to these decisions, the Tax Court in other cases and numerous District Courts have concluded, in applying the statute to various minerals in differing and complex factual situations, that Congress intended to provide flexibility in the determination of the commercially marketable products in accordance with the facts of the situation, and did not intend to have the question decided arbitrarily on an industry-wide basis.[2]

C. The first products obtained by the taxpayer which it had an opportunity to sell on a commercial basis were the burnt clay products which it sold.

The Government does not challenge the District Court's finding (Fdg. 12, R. 5), endorsed by the Court of Appeals as supported by the record (R. 267), that there was no market in which the taxpayer could have sold its fire clay and shale at a profit before it was proc-

[2] See chart of cases in Part E of Respondent's Appendix II, pp. 173-81.

essed into sewer pipe and other burnt clay products. (Br. 6, 21). However, by stating that this was due to the taxpayer's "high" mining and transportation costs (Br. 2, 6), without further explanation except a reference to its "strategic market location" as "poor" (Br. 84), the Government's brief may create the impression that the taxpayer's inability to sell raw fire clay and shale profitably was due to inefficient mining operations and poor selection of a mine location. There is no basis for such an inference. The taxpayer operated an underground mine but there is nothing to indicate that its mining costs were any higher than other similar operations. The Court of Appeals stated that the record showed that there existed in Indiana in 1951 a substantial market for fire clay and shale, but that "it is also apparent from the record that taxpayer could not have sold its fire clay and shale in that market *at a profit* because of prohibitively high mining and transportation costs." (R. 267) It is obvious from the court's discussion of the facts later in its opinion that it meant that the taxpayer's mining and transportation costs were prohibitively high in relation to those of the strip miners who supplied that market, so that the taxpayer had no access to it. The court noted that the market for fire clay and shale in Indiana existed primarily in a limited area near Brazil, Indiana (R. 271-72), which is located 140 miles from the taxpayer's mine at Cannelton. (R. 44)

The reason why the Brazil miners were able to sell clay and shale at prices below the taxpayer's mining costs was explained by the Court of Appeals as follows (R. 271):

"Those companies selling fire clay in Indiana concerning which the Government introduced evidence fall into two categories. There are those operators who engage primarily in strip mining of coal and, who, during their operations, strip bare so-called underclay which they sell as a by-product. Secondly, there are those which mine underclay which has already been laid bare by previous strip mining operations. The mining costs of such operators would be considerably below those of taxpayer which operated an underground mine."[22]

With regard to the location of the taxpayer's mine, the record shows that the clay in the taxpayer's mine was the best for making sewer pipe mined in Indiana

[22] A footnote in the Government's brief (p. 83 n.83) states that a miner located in Kentucky, directly across the river from taxpayer, sold substantial quantities of both fire clay and shale to a sewer pipe manufacturer. (See also Gov't Br. 22) This is not an accurate statement. The "miner" referred to, L. R. Chapman, did not sell fire clay and shale. He operated a coal mining, farming, and contracting business and dug ponds, built roads, and did earth movement work on a contract basis. (R. 163, 180-81) In 1951, Chapman mined and delivered clay and shale to the Owensboro Sewer Pipe Company at Owensboro, Kentucky, from a five acre tract of land which he had previously sold to that company for $50.00. (R. 168, 171-72). Chapman sold coal to Owensboro (R. 169, 245-46), and he had a contract to mine and deliver clay and shale for Owensboro at a rate of $1.40 per ton for his services. (R. 168-72). In later years, Chapman mined and hauled clay and shale for several companies under similar arrangements. (R. 173-79) In all cases the prospecting and investigation of the properties in search of suitable clay and shale and the development and preparation of mining sites were done by the companies or at their direction and expense, with the understanding that Chapman would sell or lease the land to them if desired and would have a contract to mine and haul the clay for them. (R. 180, 185)

and that the Cannelton sewer pipe was the best produced in Indiana. (R. 127) Thus the location and mining costs which excluded the taxpayer's fire clay and shale from a market were not due to inefficiency. They were essential to obtain a particularly desirable clay, but they made a market for the raw minerals economically unavailable. The encouragement of discovery and exploitation of natural resources is inherent in a concept of depletion which is not limited to a return of cost,[23] and it certainly is not inconsistent with the Congressional purpose in adopting percentage depletion to encourage a miner to develop a superior deposit of fire clay and shale rather than to develop a poorer deposit merely because its location and situation are such that the crudest form of mineral product may be sold profitably. Nor is it inconsistent with the Congressional purpose for the taxpayer to be entitled to a larger depletion allowance for its fire clay and shale than the coal strip miner at Brazil who mined and sold clay as a by-product.

On the facts as found by the District Court, the first products actually obtained by the taxpayer which it could sell on a commercial basis were the sewer pipe and other burnt clay products which it sold. This finding was approved by the Court of Appeals and is not challenged by the Government.

The District Court also found that all of the processes applied by the taxpayer were the processes "normally applied by mine owners or operators" to obtain such products. (Fdg. 10, R. 5) This finding has not

[23] See pp. 77-78 *infra*; Gov't Br. 37-38; Dragon Cement Co. v. United States, 244 F.2d 513, 514 (1st Cir. 1957), *cert. denied*, 355 U.S. 833 (1957) (Resp. App. II, pp. 11, 13).

been challenged by the Government either in the Court of Appeals (R. 272, 273) or here.

Therefore, the taxpayer is entitled to compute its deduction for depletion of its deposits of fire clay and shale on the basis of the selling price of the burnt clay products which were its commercially marketable mineral products.

D. Even if the "commercially marketable mineral product or products" are to be determined on an industry-wide basis, the judgment should be affirmed since miners of fire clay and shale normally are required to process such minerals into burnt clay products to make them commercially marketable.

We have shown that the Court below and all the other courts which have considered the question have correctly held that the statute must be applied by first determining the "commercially marketable mineral product or products" of the particular taxpayer and that "mining" then includes the processes which that taxpayer actually applies and which are the processes "normally applied by mine owners or operators" to obtain such product or products. However, even if this Court should accept the Government's contention (Br. 7) that "Congress has adopted a generic or class description—one which imposes an industry-wide test" which is "applicable to each class of mines" (Br. 27), still it does not mean that the Government should prevail in this case involving a producer of fire clay and shale.

If Congress has established an "industry-wide" test, then "mining" includes the processes which members of that "industry" (*i.e.*, producers of that mineral ac-

cording to the Government, Br. 25) *normally* apply to obtain their commercially marketable product or products. What they "normally" do must be what they do usually and ordinarily. Thus "mining" would include the processes which producers of fire clay and producers of shale normally, usually, and ordinarily apply to obtain their commercially marketable products.

Because (as shown above, pp. 28-40), the Government agreed with taxpayer in the District Court that the issue was whether the *taxpayer's* clay was commercially marketable, there is no evidence in the record to show what processes producers of fire clay and of shale in the country as a whole "normally" apply to obtain their commercially marketable products.[24]

The record does show, however, as the Court of Appeals found (R. 272), that in Indiana, where taxpayer is located, "the integrated miner-manufacturer was the rule rather than the exception" in 1951.

Furthermore, the fact is that producers of fire clay and of shale in the country as a whole *normally* must put their clay in the form of burnt clay products (such as sewer pipe) in order to obtain their commercially marketable products, as shown by the findings of fact in other cases, where the Government *did* raise this issue in the District Court and where evidence on it *was* introduced. Thus, the findings in one such case show that more than 75% of the refractory and fire clay extracted from the ground must be put in the form

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[24] In fact, the Pre-Trial Order, which the Government as well as the taxpayer approved, specifically limited the issue to be tried and precluded the introduction of any evidence on this point (pp. 37-38 *supra*).

of burnt clay products before it can be sold; that 90% of the producers of refractory and fire clay are required to put their clay in the form of burnt clay products in order to be able to sell such clay; and that:

> "Both in plaintiff's market area and in the United States as a whole, refractory and fire clay mine owners and operators normally are required to put their refractory and fire clay in the form of burnt clay products in order to obtain products which are commercially marketable." [25]

The Government in its brief (p. 82) quotes statistics (which are not in the Record) from the Minerals Yearbook of the Bureau of Mines to show the sales of fire clay in 1951. However, these figures do not show that producers of fire clay normally sell their raw clay. In fact, they support the findings in the *Elgin-Butler* and *Acme* cases.[26] Thus, they show that, in 1951, 73%

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[25] Elgin-Butler Brick Co. v. United States, 146 F. Supp. 378, 382 (W.D. Tex. 1956), *aff'd by stipulation*, 57-1 U.S.T.C. ¶ 9619 (5th Cir. 1957), *cert. denied*, 355 U.S. 824 (1957). Findings to the same effect were also made in *Acme Brick Co.* v. *United States*, 167 F. Supp. 911, 914 (N.D. Tex. 1956), *aff'd by stipulation*, 57-1 U.S.T.C. ¶ 9617 (5th Cir. 1957), *cert. denied*, 355 U.S. 824 (1957); *Acme Brick Co.* v. *United States*, 160 F. Supp. 604, 607 (N.D. Tex. 1957).

[26] It should be noted, however, that these figures published by the Bureau of Mines, although they are the only published statistics, do not give an entirely accurate or reliable report of the production and sales of fire clay and shale. For example, statistics as to each of these types of clay are lumped with statistics as to other types as well. Also, the Bureau of Mines relies on reports from producers, as compiled by state agencies, in preparing them, without checking the classification of the mineral (R. 136-37); thus, one producer may report that his clay is fire clay, whereas another producer with the same type of clay may classify his clay differently. *Cf.* R. 83.

of the fire clay *and stoneware clay* combined mined in the country was used by the producer rather than sold by the producer.[27]

With respect to shale, the figures on which the Government relies (Br. 83) show that even a greater percentage of the production is processed by the producer before being sold. Thus, the Minerals Yearbook for 1951 shows that 96% of the "miscellaneous clays, including shale and slip clay" produced was used by the producer in his own operations.[28]

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[27] U. S. Bureau of Mines, Dep't of Interior, 1951 Minerals Yearbook 294.

The Government also quotes (Br. 82) statistics compiled by the Census Bureau for 1954 purporting to show that over 4,400,000 tons were "shipped by miners" and that "a little less than 4,000,000 tons were mined and used" by producers of burnt clay products. These statistics show nothing as to *sales* of fire clay. First, these figures include diaspore, as well as fire clay and stoneware clay. Furthermore, the tonnage shown as "mined and used" includes only clay mined and used where the mine and processing plant are part of the same "establishment" *i.e.*, "a single physical location where mineral operations are conducted." The tonnage shown as "shipped by miners" therefore includes all tonnage shipped from the "mining establishment," including shipments by "mining establishments operated entirely to serve other establishments of the same company." U. S. Bureau of Census, Dep't of Commerce, 1954 Census of Mineral Industries 3, 14F-2, 14F-5.

[28] U. S. Bureau of Mines, *op. cit. supra* note 27, at 300.

Again, the Government (Br. 83) cites Census Bureau figures as showing that, in 1954, over 3,800,000 tons of "common clay and shale" were "shipped by miners" out of a total production of almost 30,000,000 tons. As explained above, note 27, these figures do not purport to show that 3,800,000 tons were *sold*, but only that this quantity was not processed at the same physical location as where the clay was extracted. Furthermore, the figures quoted are for the classification entitled "Clay, ceramic, and refractory minerals, not elsewhere classified," which is defined to include not

Certainly what is done by 10% of the producers of fire clay to 27% or less of the total production, or what is done by producers of shale to 4% of the total production does not establish what is normal or usual. *Generally* and *normally,* producers of fire clay and shale in the country must process their clay into burnt clay products in order to obtain their commercially marketable products. Thus, even if the determination of the "commercially marketable mineral product or products" is to be made on an industry-wide basis, the processes which such producers apply to obtain such burnt clay products are "the ordinary treatment processes normally applied" by producers of fire clay and of shale in order to obtain the "commercially marketable mineral product or products."

It follows, then, that, on the basis of the facts as to producers of fire clay and shale, such as this taxpayer, the Government can prevail only on the theory that "commercially marketable mineral product" is to be given the artificial meaning of a product "fit for commercial or industrial use," rather than its obvious meaning of a product which can in fact be sold on a commercial basis. It is, perhaps, for this reason that the Government has based its case here principally on this interpretation which, as we shall show below (pp. 106-09), it abandoned years ago after many courts had rejected it and which it did not present to the

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only "common clay and shale," but also "aplite, andalusite, dumortierite, kyanite, nepheline syenite, pinite, olivine, topaz, and zircon." U. S. Bureau of Census, *op. cit. supra* note 27, at 3, 14F-2, 14F-10.

courts below or in its petition for certiorari to this Court.

III

THE LEGISLATIVE HISTORY SUPPORTS THE TAXPAYER'S POSITION AND IS INCONSISTENT WITH THE GOVERNMENT'S THEORIES WHICH, IN FACT, CONGRESS HAS REPEATEDLY REJECTED.

The Government relies heavily on the legislative history of depletion, including cost and discovery value as well as percentage depletion, and the bulk of its brief (pp. 9-17, 35-80) is devoted to a lengthy discussion of such legislative history from 1913 to 1954.[1] Far from supporting the Government, the legislative history of percentage depletion supports the taxpayer's position and establishes the following principles:

(1) Congress has adopted the commercially marketable products rule to supply the base for computing the percentage depletion deduction. In so doing, it has recogniz[illegible] that various miners of

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[1] In Appendix B to its Brief, the Government has gathered much legislative material dating from 1913 through 1954. In order to make available to the Court further material which we consider relevant, we are filing herewith the following: (1) Respondent's Appendix II which contains some additional material from the period of 1913 to 1954 and additional relevant material subsequent to 1954; and (2) copies of the Hearings held by the Ways and Means Committee in 1959 concerning the Treasury's legislative proposal to abolish completely the commercially marketable products rule. *Hearings Before the House Committee on Ways and Means on Mineral Treatment Processes for Percentage Depletion Purposes*, 86th Cong., 1st Sess. (1959) (hereinafter referred to as House Hearings, 1959).

the same ore or mineral may apply different processing to obtain their commercially marketable products and that, in some cases, they will have different commercially marketable products and, thus, different bases for depletion.

(2) In establishing the percentage depletion base, Congress has never drawn any distinction between processes generally termed "mining" and those generally termed "manufacturing" and has, in fact, repeatedly rejected the Treasury's attempts to draw such a distinction.

Before discussing the legislative history of percentage depletion, it is important to note that Congress has long allowed a depletion deduction unrelated to a taxpayer's actual cost or investment in his natural deposit. Discovery value depletion, first enacted by the Revenue Act of 1918, established as the basis for depletion the fair market value of the property after discovery of the mineral or ore deposit thereon.[2] Thus, Congress established a concept of depletion which departs from usual tax concepts in order to provide an incentive to discover, develop, and operate deposits of natural resources.[3]

When Congress turned from discovery value depletion to percentage depletion, it retained the principle

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[2] Revenue Act of 1918, 40 STAT. 1057, § 214(a)(10). (Gov't App. B, pp. 3-4).

[3] Gov't Br. 37-38; House Hearings, 1925, p. 161 (Gov't App. B, p. 9); Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, 1926, pp. 3, 19 (Gov't App. B, pp. 11, 12).

of allowing a tax-free recovery greater than actual cost in order to encourage the development of natural resources.[4] In fact, as has been pointed out to Congress, percentage depletion goes further than discovery value depletion in departing from a recovery of cost because it continues as long as the deposit is operated, whereas the deduction for discovery value depletion terminated when such value was recovered.[6]

The Treasury has long fought percentage depletion as being over generous and has long sought to have it reduced or eliminated.[7] At the same time, the Treas-

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[4] House Debate, 1947, 93 Cong. Rec. 9628 (Gov't App. B, p. 257). House Hearings, 1959, pp. 22, 27, 53. In the 1959 Hearings, this fact was recognized by statements made by members of Congress, by the Treasury representative, and by a statement quoted from a report made in 1952 by the President's Materials Policy Commission.

[5] Joint Committee Report, 1930, p. 14 (Gov't App. B, p. 73).

[6] See *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 312 (1956), where this Court, after stating that depletion is designed "to permit a recoupment of the owner's capital investment in the minerals," went on to state:

> "The present allowance, however, bears little relationship to the capital investment, and the taxpayer is not limited to a recoupment of his original investment. The allowance continues so long as minerals are extracted, and even though no money was actually invested in the deposit."

[7] As early as 1934, the Treasury recommended the elimination of percentage depletion. (Gov't App. B, p. 138). It has tried continually since then to eliminate or reduce it and has opposed its extension to other minerals. One reason stated in the President's message vetoing the Revenue Act of 1943 was the provision therein extending percentage depletion to certain minerals. 90 Cong. Rec. 1958, 1959 (1944) (Resp. App. II, p. 78). The Act was passed over the Presidential veto.

ury has fought the commercially marketable products rule for computing it. Congress, however, has refused to accede to the Treasury's wishes; it has continued and extended this type of depletion and has adhered to the commercially marketable products rule. It is for Congress to make the laws and the legislative history clearly shows that Congress favors percentage depletion.

A. By enacting percentage depletion computed on the basis of the commercially marketable products rule, Congress intended to provide a simple and easily applied method of computing the depletion deduction.

The percentage depletion deduction is computed as a percentage of a dollar base termed "gross income from the property" (but is limited to 50% of "net income of the taxpayer . . . from the property"). Its application to any given taxpayer is exceedingly simple, once this dollar base is determined. Congress has elected to determine the base by use of the commercially marketable products rule. This rule furnishes a simple method for computing the deduction, since the taxpayer can readily determine the commercially marketable products which he obtains and use their selling price (if he sells them at this point) or their established market value (if he processes them further) to compute his deduction.

Congress turned to percentage depletion because of the inequities and difficulties in the administration of discovery value depletion.* In so doing, it was seeking

* The Government in its brief (pp. 11, 12, 16, 40-41, 70 (Heading 1), 71) repeatedly states that discovery value depletion was inequitable because it discriminated against small miners. It is true

a simple rule of easy application which would avoid the necessity of placing a "value" on a mine,[9] but not necessarily one that would provide the same dollar depletion deduction for all producers of the same ore or mineral. Before Congress extended percentage depletion to metal mines, the Staff of the Joint Committee

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that discovery value depletion was criticized because small miners did not have the funds required to contest the Treasury's determinations of the value of their mines. House Hearings, 1927-1928, pp. 506, 507, 508, 511 (Gov't App. B, pp. 38, 41, 45-46).

This, however, was merely one result of a basic fault of discovery value depletion, *i.e.*, the difficulty of attempting to value a mine. Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, 1926, pp. 3, 115-16 (Gov't App. B, pp. 11, 15); Senate Debate, 1926, 67 Cong. Rec. 3762 (Gov't App. B, p. 26); Joint Committee Report, 1930, pp. 1, 2 (Gov't App. B, pp. 67-68, 69); House Hearings, 1932, pp. 328, 331 (Gov't App. B, pp. 110, 112); House Hearings, 1951, pp. 1571-72, 1572-73 (Gov't App. B, pp. 291, 292).

Congress was told, in fact, that no two engineers could ever agree on a valuation, thus causing endless disputes. Senate Hearings, 1926, pp. 158, 177 (Gov't App. B, pp. 18, 19); House Debate, 1927-69 Cong. Rec. 599 (Gov't App. B, p. 48).

There were also other basic faults and inequities explained to Congress. For example, the discovery value of a given mine depended on the fortuitous circumstance of whether that mine was discovered in a time of prosperity or of depression. Joint Committee Report, 1930, p. 2 (Gov't App. B, p. 70).

[9] Partial Report of the Select Committee on Investigation of the Bureau of Internal Revenue, 1926, p. 116 (Gov't App. B, p. 15); Senate Hearings, 1926, pp. 158, 177, 197 (Gov't App. B, pp. 18, 19, 21); Joint Committee Report on Depletion, 1927, p. 13 (Gov't App. B, pp. 33-34); House Hearings, 1927-1928, pp. 161, 506, 508, 510 (Gov't App. B, pp. 36, 37-38, 40-41, 45); House Debate, 1927-69 Cong. Rec. 599 (Gov't App. B, p. 49); Joint Committee Hearings, 1930, pp. 6, 58 (Gov't App. B, pp. 90, 103); House Hearings, 1932, p. 341 (Gov't App. B, p. 117); Senate Hearings, 1932, p. 229 (Gov't App. B, p. 125).

on Internal Revenue Taxation prepared a report (the so-called Parker Report) which considered alternative methods of computing depletion: the "fixed rate per unit method," percentage depletion based on gross income, and percentage depletion based on net income. The first method would allow a fixed amount of depletion per pound for the metal sold and, thus, treat all miners of the same ore in exactly the same way. The Parker Report itself recommended against this method, one of the reasons being the very fact that it would treat all miners of an ore the same and not reflect the difference in the value of various grades of ores.[10] Congress has never given further consideration to this method. The Report also recommended against percentage depletion based on gross income because it appeared "to produce inequities in the case of certain industries."[11] This report recommended a deduction based on "net income from the property" after a reasonable amount of the net income has been allocated to the plant investment.[12] However, after extensive hearings,[13] at which arguments were presented for both gross income and net income methods, Congress chose the simple method based on gross income from the property.

[10] Joint Committee Report, 1930, pp. 12-13 (Resp. App. II, pp. 76-77).

[11] *Id.* at 3 (Gov't App. B, p. 71). See also Senate Hearings, 1926, p. 179 (Gov't App. B, p. 20).

[12] Joint Committee Report, 1930, pp. 14, 22 (Gov't App. B, pp. 73, 74).

[13] Joint Committee Hearings, 1930 (Gov't App. B, pp. 88-107); House Hearings, 1932 (Gov't App. B, pp. 108-30).

B. Congress has always intended the commercially marketable products rule and codified it in 1943 because the Treasury, which had originally accepted it, was attempting to modify it.

The statutory definition of "gross income from the property" involved in this case was enacted by the Revenue Act of 1943. It was, however, made retroactive to 1932 and the Senate Finance Committee Report stated that it "expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder."[14] Consequently, to understand this legislative history, it is necessary to go back to the Revenue Act of 1932 and the original interpretation of the depletion provisions of that Act.

Congress in 1932 extended percentage depletion to coal, sulfur, and metal mines;[15] the statute, however, did not define "gross income from the property."

Guidance as to the meaning of the statute was supplied by the so-called Shepherd Report (Gov't App. B.

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[14] S. REP. No. 627, 78th Cong., 1st Sess. 23-24 (1943) (Gov't App. B, p. 211).

[15] Revenue Act of 1932, 47 STAT. 169, § 114(b)(4) (Gov't App. B, p. 134). Previously, in 1926, percentage depletion had been granted to oil and gas. Revenue Act of 1926, 44 STAT. 9, § 204(c) (Gov't App. B, p. 31). These minerals are commercially marketable as they come from the ground and there are established posted field prices for them at that point. Joint Committee Report on Depletion, 1927, p. 13 (Gov't App. B, p. 33); Joint Committee Hearings, 1930, pp. 50, 110 (Gov't App. B, pp. 101, 105); House Hearings, 1932, pp. 339, 341 (Gov't App. B, pp. 115, 116). Gross income from the property as to oil and gas is the market value of such crude products and the statutory definition of "gross income from the property" in Section 114 (b)(4)(B), the provision here involved, was not even made applicable to them.

pp. 76-87) which, in 1929, had proposed percentage depletion for metal mines based on "gross income from the property". The Government terms this the "definitive work on the subject," (Br. 48) Shepherd reviewed the market situation as to various ores and tenfatively recommended a definition of "gross income from the property" for the regulations.[16] As to all ores, except those of gold, silver, and copper, Mr. Shepherd recommended that the market price of the crude ore or the "net smelter return" (the price miners receive from smelters for their concentrate) be used to compute "gross income from the property," since those ores are commercially marketable in the crude or concentrated form.[17] For gold, silver, and copper ores, Shepherd recommended that the product actually disposed of by the taxpayer be used, since in many cases the mine owners applied processes beyond the concentrate stage.[18]

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[16] Joint Committee Report, 1930 (App. XXXI, Shepherd Report), p. 71 (Gov't App. B, p. 87).

[17] Thus, iron ore is marketable in crude form while non-ferrous metal ores which are to be smelted are marketable in concentrate form and are generally sold to smelters. Joint Committee Report, 1930 (App. XXXI, Shepherd Report), pp. 71, 69-70 (Gov't App. B, pp. 86, 83-84); see also Gov't Br. 29 n. 14, 8.

[18] It is also significant that Shepherd based his recommendation of a 15% rate for metal mines on figures showing that the average discovery value depletion was equivalent to about 17% of "gross sales" and that "gross sales" was computed as the price of the finished metals in the case of copper, lead, gold, and silver. Joint Committee Report, 1930 (App. XXXI, Shepherd Report), pp. 65-66 (Gov't App. B, pp. 80-81); Memoranda from the American Mining Congress to the Treasury, November 1932 (Resp. App. II, pp. 141-45); Silver Subcommittee Hearings, 1942, pp. 1008-09 (Gov't App. B, pp. 186-88).

After the Revenue Act of 1932, the Treasury issued regulations containing four lists of allowable processes applicable to coal, sulfur, and the various ores.[19] Subsequent controversy centered around the fourth list, applicable to "lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product." The processes listed were:

> ". . . crushing, concentration (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined product on the other) than crushing and concentrating (by gravity or flotation)."

There are no published rulings showing how this regulation was interpreted, but other materials make it clear that the Treasury followed the commercially marketable products rule. When the regulation was drafted, representatives of the mining industry complained that it did not express the Congressional intent.[20] A statement later submitted to Congress by L. H. Parker, who had been Chief of the Staff of the Joint Committee on Internal Revenue Taxation and prepared the Parker Report (p. 81 & n.10 *supra*), and who participated in drafting the Revenue Act of 1932[21] explained:

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[19] U. S. Treas. Reg. 77, Art. 221(g) (1933) (Gov't App. B, pp. 135-37).

[20] Memoranda from the American Mining Congress to the Treasury, November 1932 (Resp. App. II, pp. 132-60).

[21] House Hearings, 1932, pp. 336-37 (Gov't App. B, p. 112).

"The mine operators protested the definitions drafted by the Commissioner for inclusion in the regulations on the grounds that they did not express the clear intent of Congress. As a result, a group of mine operators and their representatives met with the officials of the Treasury late in December 1932 to discuss the matter. In this conference, *it was agreed the definitions drafted by the Commissioner did not express the intent of Congress.* However, as the regulations containing the definitions drafted by the Commissioner had, in the interim, been printed in bound form and been delivered to the Treasury Department and were ready for issuance, the Treasury representatives expressed reluctance to withdraw said regulations on the ground such a change could not be made and have the regulations issued in time for use in connection with the returns due to be filed March 15, 1933. To meet this situation, *it was proposed that the regulations be issued as printed with the understanding the definitions would be interpreted and applied according to the meaning of the act as agreed to in that conference.* The operators agreed to this procedure. The regulations were thus issued and the definitions were applied as agreed to up to about the latter part of 1938." (Italics ours.) [22]

Pursuant to this agreement, cyanidation and amalgamation of gold and silver ores, leaching of copper ores,

[22] House Hearings, 1947, p. 3283 (Resp. App. II, p. 82). See also Senate Hearings, 1943, p. 527 (Gov't App. B, p. 202).

and the furnacing of quicksilver ores were allowed,[23] although these processes go beyond concentration by gravity or flotation.[24] Smelting, however, was not allowed.[25] Thus, the Treasury did not go as far as Shepherd had recommended as to gold, silver, and copper ores, but did allow as to these ores certain processes which take them beyond the concentrate stage. Since cyanidation, leaching and furnacing quicksilver ores are all metallurgical processes involving chemical changes, just as smelting is, it is obvious that the standard used was that of the commercially marketable product.[26]

By allowing these various processes, however, the Treasury did not treat all miners of the same ore in the same way. For example, cyanidation of gold ore and the leaching of copper ore are alternatives to smelting for extracting the metal from the ore, and, thus, the depletion base for miners of these ores varied, depending on the processes used.[27]

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[23] House Hearings, 1942, p. 1199 (Gov't App. B, p. 152); Silver Subcommittee Hearings, 1942, p. 1010 (Gov't App. B, p. 189); Senate Hearings, 1943, p. 527 (Gov't App. B, p. 203); Fernald, *Depletion and Related Problems Under the Revenue Act of 1942*, 21 TAXES 143 (Gov't App. B, p. 484).

[24] Silver Subcommittee Hearings, 1942, p. 736 (Gov't App. B, pp. 154-55).

[25] Senate Hearings, 1950, p. 782 (Gov't App. B, pp. 279-80); Fernald, *supra* note 23.

[26] See Resp. App. II, pp. 6-8.

[27] Resp. App. II, pp. 10-11. Furthermore, these regulations (Gov't App. B, p. 136) specifically allowed as to coal the processes of cleaning, breaking, and sizing (as well as loading for shipment); some types of coal are sold without the application of all of these processes. Also, sorting and concentrating were allowed as to iron ore, although these are not necessary to make all types of iron ore marketable. See Resp. App. II, pp. 8-9 and Gov't Br. 29 n.14.

Beginning about 1940, however, the Treasury changed its original position under the 1932 regulations and abandoned the commercially marketable products rule as to certain ores. Thus, it began to disallow processes such as cyanidation, leaching, and the furnacing of quicksilver ores.[28] This change in policy was fully explained to Congress in 1942.[29] The Treasury based its new position on the same ground as it urges here, *i.e.*, a theoretical distinction between mining and manufacturing. Thus, Congress was told that the Treasury was disallowing these metallurgical processes because they involved chemical changes and altered the character of the mineral.[30] This was explained on the theory that a miner who applied processes to his concentrates supplied his own market:[31]

> "They come back and say, 'Well, if the company itself owns a cyanide plant and refinery we have got there *a theoretical computation that they are selling the concentrates to themselves* after they

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[28] House Hearings, 1942, pp. 1199, 1202 (Gov't App. B, pp. 152-53); Silver Subcommittee Hearings, 1942, pp. 762, 858, 859 (Gov't App. B, pp. 161-62, 172-73, 174); House Hearings, 1947, p. 3283 (Resp. App. II, pp. 82-83); Fernald, *supra* note 23, p. 86.

[29] A member of Congress was "astonished" to learn that the Treasury was seeking to cut off the computation of the deduction for cinnabar ore before income could be realized from the ore. House Hearings, 1942, p. 1202 (Gov't App. B, pp. 152-53). The change in policy, however, was not expressed in any published regulation or ruling. Senate Hearings, 1943, pp. 527-28 (Gov't App. B, p. 203).

[30] Silver Subcommittee Hearings, 1942, pp. 858, 859, 860, 861 (Gov't App. B, pp. 172, 174, 176, 177, 178).

[31] Silver Subcommittee Hearings, 1942, p. 762 (Gov't App. B, p. 161).

get them through the flotation, and subtracting the cost of the cyaniding." (Italics ours.) [32]

The Treasury then, as now, justified its position on the basis that all taxpayers should be treated alike and feared that otherwise depletion for iron ore would be based "on the value of the steel rolled into finished shapes." [33]

Congress took no action in 1942; the Treasury opposed corrective legislation and represented that it would handle the question administratively by returning to its original practices under the regulations.[34] However, the Treasury did not do so,[35] and, in 1943, representatives of the metal ore producers again came to Congress with the same complaint.[36] This time Congress did act in the Revenue Act of 1943 by adding Section 114(b)(4)(B) to the Code, defining "gross income from the property" and specifically writing the commercially marketable products rule into the

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[32] Compare the Government's statement here (Br. 18-19):

> "If all miners of a particular mineral become integrated, thus providing their own market for the mineral product, the depletion base does not thereby come to comprehend the processes of fabrication and to multiply many times over."

See also Gov't Br. 84-85.

[33] Silver Subcommittee Hearings, 1942, pp. 763-64, 860. (Gov't App. B, pp. 164-65, 176).

[34] Senate Debate, 1942, 88 CONG. REC. 8033 (Gov't App. B, pp. 196-98).

[35] *Secretary's Report, American Mining Congress Reviews Its Activities in 1942*, 29.2 MINING CONGRESS JOURNAL, March 1943 issue, p. 22 (Gov't App. B, pp. 471-72).

[36] Senate Hearings, 1943, pp. 527-29, 928 (Gov't App. B, pp. 201-07, 209).

statute.[37] Also, to end controversy, Congress specifically listed as ordinary treatment processes the metallurgical processes which the Treasury had originally allowed in 1932 but which it later tried to exclude. The Senate Finance Committee, which added the section to the revenue bill, explained it as follows:

> "The purpose of the provision is to make certain that the *ordinary treatment processes which a mine operator would normally apply to obtain a marketable product* should be considered *as a part of the mining operation*, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines.
>
> "The law has never contained such a definition, and *its absence has given rise to numerous disputes.* The definition here prescribed expresses the *congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder.* It is therefore made retroactive to the date of such original provisions." (Italics ours.)[38]

The Government in its brief states (p. 14) that, in 1943, Congress "wrote the 1932 Treasury Regulations

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[37] Revenue Act of 1943, 58 STAT. 21, § 124 (Gov't App. B, pp. 224-25). As explained above, p. 78 n.7, this Act was passed over the President's veto.

[38] S. REP. No. 627, 78th Cong., 1st Sess. 23-24 (Gov't App. B, pp. 210-11).

into the statute" and then characterizes Section 114-(b)(4)(B) variously as a "codification" of the Treasury's 1932 regulations (Br. 55, 74 n.60), of the "essential features" of these regulations (Br. 73), of the Treasury's "original regulations and practices" (Br. 63), of the "original administrative practice" (Br. 58, Heading 4), and of "concepts which had developed over the preceding thirty years." (Br. 36) As a matter of fact, the language which is crucial to this case, that mining shall include "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products," has no counterpart in any prior statute, regulation, or ruling.

It is perfectly clear that the statute is not a codification of the 1932 regulations.[39] The entire portion of the statute preceding the four lists of processes is completely different from the regulations. The regulation requires *excluding* the cost of all processes, except those *specifically* named, which are applied to obtain the "*first* marketable *product*." The statute, however, states that "mining" shall *include* "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the *commercially* marketable mineral product *or products*." Furthermore, the lists of processes are broader in the statute. As a matter of fact, the only points of similarity between the regulation and the statute are that both start with a

[39] U. S. Treas. Reg. 77, Art. 221(g) (1933) (Gov't App. B. pp. 135-37).

statement that "gross income from the property" shall "mean," and both have four lists of processes.[40]

Furthermore, the Finance Committee Report states that Section 114(b)(4)(B) "expresses the congressional intent of these provisions as first included in the law." The Treasury itself recognized in 1932 that its regulations did not follow that intent, and, in fact, it did not originally plan to apply them as written (p. 85 *supra*). Actually, all the Finance Committee Report states is that the statute "is *in accord* with the original regulations and *the Bureau practices and procedures* thereunder." As shown above, the Treasury originally applied the commercially marketable products rule under these regulations, although it was not stated in them, and Congress obviously meant that it was adopting this rule which had originally been applied by the Treasury in interpreting and applying the regulations.

C. Congress has continued to extend percentage depletion to additional minerals, always adhering to the commercially marketable products rule and rejecting the Treasury's attempts to modify or abolish it.

Beginning in 1942, Congress granted percentage depletion to additional minerals until, finally, in 1954, it granted it to all minerals.[41] In so doing, Congress obviously intended to provide an incentive to discover

[40] See also the discussion of the Government's argument in *Dragon Cement Co.* v. *United States*, 244 F.2d 513, 519 (1st Cir., 1957), *cert. denied*, 355 U.S. 833 (1957) (Resp. App. II, pp. 11, 26).

[41] The only exceptions are soil; sod; dirt; turf; water; mosses; and minerals from sea water, the air, or similar inexhaustible sources. INT. REV. CODE OF 1954, § 613(b)(6) (Resp. App. II, pp. 112-13).

and develop deposits of the various minerals, and it recognized that it was not merely providing a return of the mine owner's capital.[42] It is also obvious that Congress has adhered to the commercially marketable products rule for determining the depletion base, amending the statute in 1950 when the Treasury tried to modify that rule, and refusing to change it when the Treasury attacked it in 1954, 1958, and 1959.

1. *In 1950, Congress specifically included "transportation" in "mining" because the Treasury was seeking to exclude it and thereby modify the commercially marketable products rule.*

In 1950, Congress amended Section 114(b)(4)(B) to add to "mining" transportation of the ores and minerals from the point of extraction to the mill or plant where the ordinary treatment processes are applied.[43] Obviously, transportation is not within any commonly understood definition of "mining." However, where there is such transportation, it must be included in the depletion base to follow the statutory scheme of using the selling price of the commercially marketable products as the depletion base. The Treasury had originally allowed "gross income from the

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[42] The Government states (Br. 70) that, "The industry has repeatedly urged [percentage depletion] as a fair and equitable method of measuring the exhaustion of capital assets." Actually, producers of the various minerals, as well as others, have urged percentage depletion as a method of tax relief which provides both the incentive and funds to prospect for and develop new deposits of the various ores and minerals. See, for example, the excerpts from the House Hearings, 1947, 1950, and 1951, reproduced in Resp. App. II, pp. 79-80, 83-106.

[43] Revenue Act of 1950, 64 STAT. 906, § 207 (Gov't App. B, p. 287)

property" to be computed without adjustment for such transportation, but had recenty changed its position.[44] Thus, again, as in the Revenue Act of 1943, Congress had to act to prevent the Treasury's whittling away at the commercially marketable products rule.

2. *In 1951, when Congress granted percentage depletion to fire clay and shale, it intended that the deduction be computed in accord with the commercially marketable products rule.*

In 1951, when Congress added fire clay and shale to the minerals granted percentage depletion, there is nothing in the legislative history to show that Congress intended that the allowance for these minerals should be computed in any way other than that by which it is computed for all other minerals, *i.e.*, under the commercially marketable products rule.[45] A letter written on June 4, 1955, by Senator George, Chairman of the Senate Finance Committee in 1951, to T. Coleman An-

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[44] Senate Hearings, 1950, pp. 771, 772 (Gov't App. B, pp. 275, 276).

[45] In an attempt to show that the "commercially marketable mineral product" of fire clay is raw clay, the Government discusses the testimony in 1950 of a representative of the refractories industry, who requested percentage depletion on "the 'value' of 'raw materials used.'" (Gov't Br. 79-80). Actually, this witness did not request depletion for "fire clay" as such at all. Instead, he sought depletion for "refractory clays and quartzite," and stated that this term would not include "deposits of clays and silica rock not used for refractories." He argued against using the term "fire clay" because it also embraces other clays "not distinctively refractory minerals." House Hearings, 1950, pp. 449-50 (Gov't App. B, pp. 337-38). Taxpayer is not in the refractory industry and does not produce refractory products. Obviously, when, in 1951, the subsequent Congress allowed percentage depletion for "refractory *and fire* clay," it had in mind clays different from those mentioned by this witness.

drews, then Commissioner of Internal Revenue, explains with specific reference to brick and tile clay (which was also granted percentage depletion in that year) that the commercially marketable products rule was specifically intended:[46]

> "... [T]he statute defining mining for purposes of computing depletion allowance for federal income and excess profits tax purposes does not exclude manufacturing processes so long as they are ordinary processes normally and necessarily used in obtaining commercially marketable mineral products.
>
> "I personally recall the discussion in executive session between members of the Senate Finance Committee when this statute was under consideration. At the time it was not only understood but I pointed out what I knew and believed to be the facts about brick manufacture. ... Brick clay at this time has no commercial value until it is baked or cooked. The Senate Finance Committee certainly understood this clearly, before the Act, giving depletion allowance to brick clay, was passed."[47]

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[46] This letter is referred to and quoted in part in the House Hearings, 1959, pp. 258, 264, and was reproduced in full with Senator George's approval, in *Brick and Clay Record*, Vol. 130, No. 1, at 87-88 (January 1957). It is set forth in full in Resp. App. II, pp. 163-65.

[47] See also House Debate, 1950, 96 CONG. REC. 15590 (Gov't App. B, pp. 286-87) on the Revenue Act of 1950, which, as explained above, specifically added certain transportation to "mining." The

Apparently to try to show the contrary, the Government states (Br. 65-66) that the Senate passed an amendment to the Technical Changes Act of 1949 which would have extended percentage depletion to "all other nonmetallic clays and minerals" and concludes that "it is significant that a broad extension of the allowance to numerous additional minerals was not thought to require any modification of the method of computing the allowance"; it then quotes a statement in the Finance Committee Report that "It is not proposed to allow percentage depletion with respect to the value added as the result of grinding or other special preparation," because "many" of the extractors "sell these minerals in crude form."

The Government's argument could be interpreted as implying that the statement in the Finance Committee Report refers to "all other nonmetallic clays and minerals." Actually, this statement was made with reference only to perlite and diatomaceous earth, the only minerals granted percentage depletion by the bill as reported by the Finance Committee and to which this Committee Report relates.[48] The amendment extending depletion to "all other nonmetallic clays and minerals" was added *subsequently* on the floor of the Senate.[49] The entire amendment, as to all minerals

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statements of Representative Jenkins, a member of the Ways and Means Committee, show that he contemplated that, if percentage depletion were extended to clay, the processes of making brick would be included in "mining."

[48] S. Rep. No. 831, 81st Cong., 1st Sess. 9-10 (Gov't App. B, pp. 246-47).

[49] Senate Debate, 1949, 95 Cong. Rec. 12994.

including perlite and diatomaceous earth, was removed by the Conference Committee, "with the understanding that the entire matter of percentage depletion will be considered early next year after full study and hearings." [50] It is significant that the subsequent Congress which did enact percentage depletion for these minerals (in 1951) after further study made no such statement.

3. *In 1954, Congress reaffirmed the commercially marketable products rule and rejected an attempt to abolish it as to brick and tile clay.*

In the hearings on the Internal Revenue Code of 1954, Congress was requested by industry representatives to add, and did add, to the ordinary treatment processes specifically listed in the statute, the pulverization of talc; the burning of magnesite; the sintering and nodulizing of phosphate rock; and dust allaying and treating to prevent freezing of coal.[51]

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[50] H. R. REP. No. 1412, 81st Cong., 1st Sess. 11 (Gov't App. B, p. 248).

[51] INT. REV. CODE OF 1954, § 613(c)(4)(A), (E), (Resp. App. H, p. 114). House Hearings, 1953, pp. 2035-42, 2059-60 (Gov't App. B, pp. 448-51, 394-95); Senate Hearings, 1954, pp. 1334-37, 1409-13 (Gov't App. B, pp. 398-401, 342-48).

Although these processes must be applied to talc and magnesite to obtain commercially marketable products, the Treasury had sought to exclude them. *Townsend* v. *The Hitchcock Corp.*, 232 F. 2d 444 (4th Cir. 1956) and *International Talc Co.*, 15 T.C. 981 (1950), as to talc, and *Northwest Magnesite Co.* v. *United States*, 58-1 U.S.T.C. ¶ 9394 (E.D. Wash. 1958), as to magnesite.

Treatment to prevent freezing is applied to coal only where and when the climate requires it; dust allaying is applied to only about 9% of the coal produced, but is necessary to obtain a particular commercially marketable product of coal (*i.e.*, coal for domestic use). See Senate Hearings, 1954, pp. 1409-13 (Gov't App. B, pp. 343-48; Resp. App. H, p. 9).

The Treasury, on the other hand, sought to abolish the commercially marketable products rule as to brick and tile clay and substitute its theory distinguishing between mining and manufacturing. The Ways and Means Committee announced on February 18, 1954, during its consideration of the Internal Revenue Code of 1954, that such a provision was being added to the draft of the bill and stated that the law "has been interpreted [by T.D. 6031, approved July 14, 1953, discussed below, p. 106] in the same way as specifically provided by the Committee's bill."[52] A few days later, on February 24, 1954, the Committee reversed its action and stated:

> "The Committee reconsidered a previous decision it made with respect to percentage depletion on brick and tile clay. Previously the Committee had agreed to include a specific provision in the bill that ordinary treatment processes with respect to brick and tile clay were not to include 'molding, shaping, extruding, firing, or burning,' in order to resolve a question which exists under present law. The Committee agreed not to include this specific phrase, thus leaving the treatment of these processes to be determined under existing law."[53]

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[52] Committee on Ways and Means, House of Representatives, Press Release #24, Feb. 18, 1954 (Resp. App. II, pp. 107-08).

[53] Committee on Ways and Means, House of Representatives, Press Release #27, Feb. 24, 1954 (Resp. App. II, p. 108).

The District Court decided *Cherokee Brick & Tile Corp.* v. *United States*, 122 F. Supp. 59 (M.D. Ga. 1954), *aff'd*, 218 F.2d 424 (5th Cir. 1955), involving brick and tile clay, in favor of the taxpayer on June 4, 1954, and the Internal Revenue Code of 1954 did not pass the Senate until July 2, 1954. Yet Congress did not act in 1954 to change the result in that case and, in fact, has not since acted.

4. *In 1958, Congress refused to adopt the Treasury's proposal to abolish the commercially marketable products rule as to clay and as to minerals used for cement.*

After Congress refused to act as to brick and tile clay in 1954, the Treasury made no further legislative attempts to change the commercially marketable products rule until, after long litigation and denial of certiorari by this Court, it accepted the unanimous holdings of the cases as to brick and tile clay and cement rock in T.I.R. 62, issued on October 18, 1957.[54] Promptly thereafter, however, on January 16, 1958, The Secretary of the Treasury asked Congress to enact the theories advanced here by the Government. He said:

> "Last October, the Supreme Court denied a petition for certiorari in a series of cases dealing with the so-called cutoff point for percentage depletion in the manufacture of bricks and cement.
>
> "*The net result of the cases is to apply the percentage depletion allowance to the price of finished manufactured products,* bricks and cement, rather than to the value of the clay and the cement rock before it is manufactured.
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> * * * * *
>
> "*The problem appears to arise from the application of the phrase 'the commercially marketable mineral product or products' in the statute.* I recommend the law be revised to prevent these excessive depletion deductions. The revenue loss in

[54] 1957 INT. REV. BULL. No. 43, at 51; 5 CCH 1957 STAND. FED. TAX REP. ¶ 6824; 4 P-H 1957 FED. TAX SERV. ¶ 76,726 (Resp. App. II, pp. 165-66).

the two industries directly covered by the cases is about $50 million a year." (Italics ours.)[55]

On April 24, 1958, the Treasury submitted to Congress proposed legislation which would enact its position as to clay and as to minerals used for cement. The transmittal letter, from Dan Throop Smith, then Deputy to the Secretary of the Treasury, shows that the Treasury considered it settled that "manufacturing" processes could be "mining" under the statutes and that it lacked confidence in the other arguments which the Government presents here:

"... *The result of the court decisions is that a taxpayer who extracts the mineral from the ground and applies processes thereto may base his depletion allowance on income from the commercially marketable product, regardless of whether or not his processes are manufacturing processes.* It is believed that depletion on this scale is excessive and was not intended.

* * * * * * *

"In the absence of further legislation providing a specific cut-off point for other minerals and ores, this Department will continue to face substantial problems in determining for many mineral industries the stage at which taxpayers first obtain a commercially marketable mineral product. There is, for example, a question as to whether the stage

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[55] House Hearings, 1958, pp. 1097-98 (Resp. App. II, p. 115).

should be determined by reference to the taxpayer's own local market or the national market. In some cases the local market approach would have the effect of obtaining a different cut-off for the same mineral in different areas of the United States. *On the other hand, the national market approach, while establishing a uniform first commercially marketable product for an entire industry, would be difficult to apply in instances where there is no readily available data with respect to the minerals concerned. Moreover, there is a question as to whether the courts would accept the national market approach as the correct construction of the statute.*" (Italics ours.)[56]

Congress, however, took no action on this proposal; no hearings were held and no bill was introduced.

5. *In 1959, Congress refused to adopt the Treasury's proposal to abolish the commercially marketable products rule as to all minerals.*

The Treasury renewed its efforts to obtain legislation in 1959, recommending that the commercially marketable products rule be abolished for all minerals and ores. The President's Budget Message contained a statement as to the need for legislation in this area.[57] On January 26, 1959, the Secretary of the Treasury wrote to the Speaker of the House, stating:

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[56] Treasury Proposal, 1958 (Resp. App. II, pp. 116, 118-19, 120).

[57] Presidential Budget for 1960—Message from the President of the United States (H. R. Doc. No. 15), 105 Cong. Rec. 816, 817-18 (1959) (Resp. App. II, pp. 123-24).

"It is now apparent under the court decisions that manufacturers of many other products may obtain depletion allowances based on gross income derived from the sale of finished products. . . .

"The problem arises because the term 'mining' is defined in the statute to include the ordinary treatment processes normally applied to obtain the 'commercially marketable mineral product or products' *which, in many instances, may be an expensive finished product.* Accordingly, in order to prevent excessive depletion allowances, *I recommend the immediate elimination of the phrase 'commercially marketable mineral product or products' from the statute and the substitution of a new definition of 'mining' which will specify the allowable treatment processes for the various minerals.*

"The proposed legislation would not only prevent a substantial loss in revenue, but would also help resolve difficult and complex problems in determining for many mineral industries the stage at which taxpayers first obtain a commercially marketable mineral product." (Italics ours.) [58]

On February 11, 1959, the Secretary submitted a legislative proposal to accomplish this purpose.[59] The Ways and Means Committee held five days of hearings on this proposal.[60] At these hearings, the Treasury

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[58] Treasury Proposal, 1959 (Resp. App. II, pp. 124, 126).

[59] Treasury Proposal, 1959 (Resp. App. II, pp. 128-32).

[60] House Hearings, 1959. For the Court's convenience, copies of these Hearings are being filed herewith.

stated that "this legislative recommendation is one of the most important pieces of tax legislation which will be considered by the Congress this year" (House Hearings, 1959, p. 2), and presented to the Committee the same theories which it presents here. It urged that only "mining" processes should be allowed and "manufacturing" processes should be disallowed (*Id.* at 7-9, 20, 50);[61] it argued that the present statute, as interpreted by the courts, creates discrimination among taxpayers, *accepting* the fact that the cases establish that different taxpayers may have different commercially marketable products (*Id.* at 18, 25, 35, 36, 43, 44, 47, 55); it argued that this interpretation will encourage "integration" (*Id.* at 4, 6, 29); and it submitted tables as to revenue loss identical to those it presented in its petition for certiorari in this case.[62] The Treasury's proposal and arguments were received with a general lack of enthusiasm by the Ways and Means Committee.[63] Members of the Committee feared

[61] Inconsistently, however, the Treasury proposed to continue to allow certain processes (*i.e.*, cyanidation, crystallization, precipitation, and leaching) which it recognized as "manufacturing" processes. House Hearings, 1959, p. 7. In addition, it developed a new but undefined concept of "neutral" processes, i. ither mining nor manufacturing, which apparently would be disallowed but which would not have the effect of making subsequent "mining" processes unallowable. *Id.* at 8-9.

[62] House Hearings, 1959, pp. 11-13; Pet. for Cert. 39-41 (App. C).

[63] For example, after hearing representatives of the brick and tile industry, Representative Mason stated (House Hearings, 1959, p. 270):

> "In my opinion you three men, plus the testimony of Mr. Vinson, have placed the last nail in the coffin of that proposed scientific formula that the Treasury wants us to adopt as a basis for depletion allowance, instead of the commercially

that departure from the established commercially marketable products rule would create confusion[64] and put too much power in the hands of the Treasury to determine how to compute the depletion deduction.[65]

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marketable value, which is a definite thing and can be arrived at definitely.

"So far as I am concerned that proposal is dead."

[64] For example, Representative Ikard stated (*Id.* at 45):

"It still looks to me as if, rather than bringing about uniformity of treatment, conceivably you could be developing more confusion and certainly an area in which there no doubt would be a great deal of litigation over this cutoff point."

Representative Simpson stated (*Id.* at 55):

"Certainly we have comparative stability. The Department has been told by the courts just where depletion is to apply, the amount of money, based upon decisions at hand, is not too large, in my judgment.

"Certainly it is a small price to pay for stability in a field where cases have been hanging open for years, 6, 7, or 8 years, because we have not been able to reach an administrative decision. I think we might advisedly retain something that gives us an element of certainty rather than adopt the terrific uncertainty that we would find from the approval of a new approach to this question."

[65] Thus, Representative Simpson stated (*Id.* at 54, 55):

". . . But how do you think the country would profit from the uncertainties that are always incident and arise when individuals are given what can amount to the question of life or death over an industry? I am advised in some of the fields, certainly with respect to some corporations, the amount returnable or retainable by the taxpayer as a result of depletion allowance does represent economic life or death to the company.

* * * * *

"I wish you would come in with firm standards and tell us exactly what you want done in these different areas. I could listen and give it some consideration. But I personally cannot view with favor any proposal that further increases the position of power of individuals to hold life or death authority over any of our industries."

The Treasury's inability (discussed at pp. 109-12 *infra*) to develop a definite rule under its theories presented here, which are the same it presented to Congress, shows that these fears were not unjustified. The Ways and Means Committee has not reported a bill and Congress has taken no further action.

D. In summary, the legislative history supports taxpayer's position.

1. *Congress has consistently used the commercially marketable products rule to supply the base for computing the percentage depletion deduction. In so doing, it has recognized that various miners of the same ore or mineral may apply different processes to obtain their commercially marketable products and that, in some cases, they will have different bases for depletion.*

The legislative history makes it clear that Congress has always regarded the commercially marketable products rule as central to its concept of percentage depletion. Congress first enacted this rule specifically in 1943 because the Treasury, having first applied it, was departing from it.

Congress has recognized, in the listed processes, that various miners of the same ore or mineral will apply different processes to obtain their commercially marketable products and that, in some cases, they will have different commercially marketable products, and thus different bases for depletion.[66] Congress has never shown an intent to give all miners of the same mineral the same depletion deduction and, in turning to percentage depletion, actually rejected a method ("fixed

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[66] See Resp. App. II, pp. 8-11.

rate per unit") that would have done exactly that. Congress has shown, instead, a consistent determination to maintain the commercially marketable products rule as a simple and practical means of determining the percentage depletion deduction.

2. In establishing the percentage depletion base, Congress has never drawn any distinction between processes generally termed "mining" and those generally termed "manufacturing" and has in fact repeatedly rejected the Treasury's attempts to draw such a distinction.

Congress has, in some cases, specifically included "manufacturing" processes (as the Government defines this term) in mining. Congress, in fact, enacted Section 114(b) (4)(B) because the Treasury was attempting to apply its "manufacturing" concept administratively at a time when the statute was not specific. In 1950, Congress specifically included in "mining" certain transportation, an item no one would ever consider to be "mining" within the commonly understood meaning, when the Treasury sought to whittle away at the commercially marketable products rule by excluding such transportation from the depletion base. And Congress in the last six years has rejected three direct attacks by the Treasury on this rule—as to brick and tile clay in 1954; as to clay and as to minerals used for cement in 1958; and as to all minerals and ores in 1959.

IV

THE GOVERNMENT'S POSITION DOES NOT LEAD TO A CONSISTENT OR COHERENT MEANS OF CONSTRUING AND APPLYING THE STATUTE.

A. The Government has developed many theories, none of which can be reconciled with the words actually used in the statute.

The Government's argument that income from "manufacturing" processes cannot be included in computing the depletion base is not new. As we have shown (pp. 82-91 *supra*), Congress enacted Section 114(b)(4)(B) in the Revenue Act of 1943, because the Treasury was then taking this same position. The Treasury returned to this position by amending its regulations in 1953,[1] after fire clay, shale, brick and tile clay, and other minerals had been granted percentage depletion in 1951. This amendment to the regulations was promptly challenged in court,[2] and the Government was then forced to try to square its position with the statutory language.

At first, it argued that "commercially marketable" means ready for use in "manufacture," the same position it takes here.[3] After losing two cases in the Courts

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[1] T.D. 6031, 1953-2 CUM. BULL. 120, amending Section 29.23(m)-1(f) of Treasury Regulations 111 (Resp. App. I, pp. 125-28 *infra*).

[2] Cherokee Brick & Tile Co. v. United States, 122 F. Supp. 59 (M.D. Ga. 1954), filed on September 3, 1953. The decision for the taxpayer was affirmed. 218 F.2d 424 (5th Cir. 1955).

[3] Thus the Government argued in the *Cherokee* case:

> "The *clay* on which depletion is allowed has reached as fine and marketable a form as it ever will prior to becoming brick

of Appeals,[4] it turned its attention to "mineral product" and argued that a "manufactured" product cannot be a "mineral" product. After three Courts of Appeals rejected this argument,[5] it argued to this Court in a petition for certiorari in 1957 that "the depletion base ('gross income from mining') contemplated by Congress has reference to income received from a mineral product resulting from a definite pattern of treatment processes," which excludes "manufacturing."[6]

After this Court denied the writ in 1957,[7] the Government dropped its "manufacturing" argument and the Revenue Service announced its acquiescence in the decisions holding that "manufacturing" processes are

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at the time it enters the pugmill. As clay, it is then in the form of a commercially marketable product. That the prohibitive expense involved in its transportation discourages an active market for the material cannot change the fact that it is ready for use in brick and tile manufacture." Brief for Appellant, p. 19, United States v. Cherokee Brick & Tile Co., 218 F.2d 424 (5th Cir. 1955).

Compare the Government's use here (Br. 18, 21, 25, 26, 76, 78, 80, 85, 90) of "fit for commercial or industrial use."

[4] United States v. Cherokee Brick & Tile Co., note 2 *supra*; Townsend v. The Hitchcock Corp., 232 F.2d 444 (4th Cir. 1956).

[5] Dragon Cement Co. v. United States, 244 F.2d 513 (1st Cir. 1957), *cert. denied*, 355 U.S. 833 (1957) (Resp. App. II, p. 11); United States v. Sapulpa Brick and Tile Corp., 239 F.2d 694 (10th Cir. 1956); United States v. Merry Bros. Brick and Tile Co., 242 F.2d 708 (5th Cir. 1957), *cert. denied*, 355 U.S. 824 (1957).

[6] Petition for Certiorari, p. 13, United States v. Merry Bros. Brick and Tile Co., No. 220, October Term, 1957.

[7] 355 U.S. 824 (1957). The Government also filed a petition for certiorari in *Dragon Cement Co.* v. *United States*, 244 F.2d 513 (1st Cir. 1957), which was also denied at the same time, 355 U.S. 833 (1957).

within the statutory definition of "mining" when applied to obtain the commercially marketable products.[8] Before the District Court in this case, the Government merely tried to show a market for taxpayer's fire clay and shale in crude form (pp. 28-40 *supra*). After being unsuccessful in this attempt, it shifted to a new position in the Court of Appeals, emphasizing the words "normally applied by mine owners or operators" and arguing that, for each "mining" industry, there is only one "commercially marketable" product which is the "cheapest" or "least processed" product which can be sold anywhere in the United States in more than negligible quantities.[9] The court below, as well as a number of other lower courts, rejected this argument.[10] The Government made the same argument in its petition for certiorari to this Court (Pet. for Cert. 14-17), stating that the issue here is "discrete," "entirely distinct," and "distinct" from the issue in earlier cases

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[8] T.I.R. No. 62, 1957 INT. REV. BULL. No. 43, at 51 (Resp. App. II, pp. 165-66).

[9] The Court of Appeals stated (R. 269-70) that the argument that depletion could not be computed on the basis of the selling price of "manufactured" products "has definitely been laid to rest." The Government stated in its brief in the Court of Appeals (p. 14):

> "It is our position that the definition of 'mining' in Section 114(b)(4), as implemented by the definitions of 'ordinary treatment processes,' contemplates a single product as the depletable product for each mineral, albeit in some instances—namely, where the mineral is not marketable in mineral form—that product will necessarily be a manufactured product."

[10] *E.g.*, Commissioner v. Iowa Limestone Co., 269 F.2d 398 (8th Cir. 1959) (Resp. App. II, p. 28); Albin C. Halquist, 33 T.C. 304 (1959) (Resp. App. II, p. 44).

where it tried to exclude all "manufacturing" from "ordinary treatment processes." (Pet. for Cert. 5 n.5, 12, 14) [11] Now that certiorari has been granted, it interprets "commercially marketable" as "fit for commercial or industrial use" or ready for manufacture, returning to the original argument which it first made years ago but which it had not previously made in this case.

None of these theories advanced by the Government can be reconciled with the words used by Congress in adopting the commercially marketable products rule. The Government's difficulty and vacillation in attempting to square its basic position (distinguishing "mining" from "manufacturing") with the statute shows that it is trying to read into the statute something which is not there.

B. The Government has not taken a position as to how this taxpayer's depletion deduction should be computed under its interpretation.

Although the Government asserts (Br. 17) that "The application of the statute (as we interpret it) to this case presents no difficulty," it nowhere states how the statute should be applied to this taxpayer; instead, it asks (Br. 91) this Court to reverse and remand so that taxpayer's " 'gross income from mining' may be determined in the light of the correct legal criteria"—which the Government expects this Court to develop.

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[11] In its petition for certiorari, the Government stated (p. 17):

"What is involved here is not the question whether manufacturing processes are includable in the depletion base in situations where it is necessary to do some manufacturing to get the *first* commercially marketable product."

The failure of the Government to take a position as to how the taxpayer's depletion deduction should be computed shows the weakness of its case.

The Government says only (Br. 80, Heading III) that taxpayer's depletion deduction must be computed "with reference to" the crude minerals (raw fire clay and shale).[12] If a "market or field price" is to be used,[13] what is the relevant area which must be studied to determine it? Should it be determined on a "national" basis or a "local" basis? If a "local" basis is used, what is the critical local market area? Is it that area in which the taxpayer could be competitive in a practical, business sense? There is no such area in the case of this taxpayer. If some other area is to be used, there is no logical basis for using any area short of the whole

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[12] In the Court of Appeals, the Government even showed doubt as to whether raw clay is the first commercially marketable product under its theory in that court, and stated in its brief (p. 28):

> "If the Court accepts our legal position—that is, that the depletable product is that commercially marketable product which is obtainable from the particular mineral with the least processing—but is not sufficiently convinced that raw fire clay and shale are the first commercially marketable products of fire clay and shale deposits, we suggest that the case be remanded for further evidence as to the first marketable product. . . ."

It went on to suggest in its brief (p. 29 n.18) that "the next commercially marketable product after raw clay may be ground fire clay" and that "the next possible commercially marketable product obtainable with the least processing may be common brick," since "except under unusual circumstances, brick is marketable in most any area."

[13] *Cf.* U. S. Treas. Reg. 111, § 29.23(m)-1(f) (Resp. App. I, pp. 125-28 *infra*).

country (which turns the "local" basis into a "national" basis), or even the whole world, since the depletion deduction is available to producers subject to the United States income tax regardless of where their mines are located.

Aside from the difficulties of determining the relevant area, there are other problems. For example:

(1) Is the "market or field price" to be computed "as of the date of sale" or as an average for some period? [14]

(2) In the case of fire clay, is such market price to be computed on the basis of an overall average of the unit prices at which all kinds of fire clay were sold, even though there are many varieties of fire clays which vary widely in utility and value? [15]

(3) Are the prices of fire clay and shale sold as by-products by coal strip miners relevant in determining the depletion deduction of producers of fire clay and shale from underground mines? [16]

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[14] The regulation, note 13, p. 110 *supra*, contemplates the use of the price "as of the date of sale," thus requiring a day to day determination.

[15] Even on the basis of the statistics on which the Government relies, the average value per ton of fire clay sold by producers in 1951 varied from $1.35 in the State of Washington to $8.63 in New Jersey. U. S. Bureau of Mines, Dep't of Interior, 1951 Minerals Yearbook 294. This information would, in any event, be of no help to a taxpayer in filing his return, because of the delay in its publication. For example, the Minerals Yearbook for 1951 was not published until 1954.

[16] Use of such prices in the Brazil, Indiana, area to determine this taxpayer's depletion base would deny taxpayer any percentage depletion at all, because of the limitation of the deduction to 50% of net income "from the property."

If the Government says a market price is not to be used, it may turn to the "proportionate profits" method described in the regulations.[17] This method allocates gross income to the various processes on the basis of proportionate costs. The Government's brief does not assert that it should be used in this case. Determinative as far as this case is concerned, however, is the fact that in the District Court, both in its Pre-Trial Brief (pp. 6-7) and in its Post-Trial Brief (pp. 6, 18-19), the Government made it clear that it was not urging or relying on this method because it had been "abrogated" and had been "abandoned" by the Internal Revenue Service.[18]

C. The Government's theories cannot be applied consistently with the legislative intent in other factual situations.

Although the Court is expected to decide only the case before it, it seems appropriate to call the Court's attention to the confusion and illogical results which would be caused by the application of the Government's theories to other factual situations.

For example, a talc producer makes two entirely different products by entirely different processes: (1) pulverized talc, the product which the great majority of

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[17] U. S. Treas. Reg. 111, § 29.23(m)-1(f) (Resp. App. I, pp. 125-28 *infra*).

[18] The Treasury's Proposed Regulations, Section 1.613-3(b), defining "gross income from the property" under the Internal Revenue Code of 1954, also abandoned this method and substituted three alternatives. These Proposed Regulations were issued on November 3, 1956; Fed. Reg. Vol. 21, No. 215, p. 8439 at 8450, but have not yet been adopted. The proposed new methods are discussed and criticized in the House Hearings, 1959, pp. 267-69.

talc producers make and sell; and (2) sawed talc crayons which are much more expensive because suitable talc is rare.[19] If pulverized talc is the "basic mineral product," [20] how is "gross income from the property" to be computed in the case of the more valuable talc used for crayons which are produced by different processes? If the only ordinary treatment processes are those applied to obtain the pulverized talc, so that there would be no "ordinary treatment processes" applied to obtain the crayons, then some "value" for raw talc must be used (although there is no market for it) and the taxpayer's deduction may well be smaller in the case of the more valuable talc.

In a similar situation involving a stone quarry producing both dimension (building) stone and crushed stone from different grades of stone, the Government argued that the market price per ton of crushed stone should be applied in computing the deduction for the dimension stone.[21] If this method (which does not recognize the greater value of the stone suitable for dimension stone) is to be used, then how is the "net income of the taxpayer . . . from the property" to be computed for purposes of the statutory limitation of the deduction to 50% of such net income? The processing of, and therefore the costs to produce, the two prod-

[19] See Record Appendix to Brief for Appellant, pp. 62, 115-16, 140, 184-87, Townsend v. The Hitchcock Corp., 232 F.2d 444 (4th Cir. 1956).

[20] In 1954, Congress specifically listed the pulverization of talc as an "ordinary treatment process." INT. REV. CODE OF 1954, § 613(c)(4)(E) (Resp. App. II, p. 114).

[21] Albin C. Halquist, 33 T.C. 304 (1959) (Resp. App. II, p. 44).

ucts are entirely different. Application of the per ton cost of crushed stone to dimension stone involves pure speculation, especially for those producers of dimension stone who produce no crushed stone at all.

The Government invites this Court to overrule the *Merry Brothers* line of cases involving brick and tile clay. (Br. 18-19, 90-91) There is no market for such clay anywhere in the country to provide what the Government calls (Br. 18) "conclusive proof" of the point at which such clay is "fit for commercial or industrial use." Is the clay, then, "fit for commercial or industrial use" as it comes from the ground, as it enters the pugmill (the "cut-off point" first adopted by the Commissioner under his 1953 regulation),[22] or at some other point? If the first process after extraction is not included, there are no "ordinary treatment processes" as to brick and tile clay; if it is included, then there is no logical or reasonable basis for saying that "industrial use" begins with any one of the succeeding processes as distinguished from any other.[23]

Any explanation the Government may give of how the depletion deduction should be computed in these

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[22] Rev. Rul. 54-109, 1954-1 CUM. BULL. 62 (Resp. App. II, pp. 161-62).

[23] The uncertainty is shown by *Cherokee Brick & Tile Co. v. United States*, 122 F. Supp. 59, 65 (M.D. Ga. 1954), *aff'd*, 218 F. 2d 424 (5th Cir. 1955):

> "The defendant here contended that mining ceased after the fifth process [*i.e.*, before final grinding, 122 F. Supp. at 61] but in argument admitted that it might be that it should include one or two more of the processes. . . . The difficulty of finding a definite 'cut off point' in this case clearly shows the difficulty which may frequently arise in attempting to apply such a definition as that contended for by the defendant."

various situations will of necessity involve arbitrary distinctions and theoretical computations which will produce results inconsistent with the legislative intent.

D. The difficulties which the Government finds in the commercially marketable products rule are not persuasive.

The Government's position against the commercially marketable products rule cannot be squared with the statutory language or the legislative history, and its criticisms of the rule have not persuaded Congress to change it. The Government, however, asks the Court to consider what it describes as the "extreme" results of the rule. The Government then proceeds to discuss what it considers the "implications" of the decision below. (Gov't Br. 22-25)

First, the Government claims that the lower court's interpretation of the statute will result in "sharp disparities and widespread discrimination" between the "integrated miner" and others. Certainly Congress meant to adopt the same rule, *i.e.*, the commercially marketable products rule, for computing percentage depletion for all miners of the same mineral (and indeed for all mine owners and operators), but this does not mean that Congress intended that all miners of the same mineral would be entitled to the same amount of depletion. A statute basing the depletion allowance on a percentage of "gross income from the property," limited to 50 percent of the taxpayer's net income from the property, obviously will result in different amounts of depletion allowances for miners of the same mineral. The Government's interpretation would limit the miner of a more valuable grade of a mineral to the same de-

pletion allowance as the operator of an inferior deposit, as the Government attempted to do in the *Iowa Limestone* case, pp. 64-66 *supra*. This would result in discrimination which clearly was not intended by Congress.

The Government has made no case that the "disparities" of which it complains are inconsistent with the Congressional intention. Its examples from the Record in this case are not convincing. As one example, the Government (Br. 22) describes a "non-integrated miner" in the same area as the taxpayer who was delivering fire clay and shale to a "local manufacturer" for $1.40 a ton and says his depletion deduction would be 15 cents a ton. Actually, this "non-integrated miner" did not sell fire clay and shale, but was a contractor who extracted and hauled the clay and shale for the mine owner (the "local manufacturer" referred to by the Government) at a rate of $1.40 a ton for his services. (See p. 69 n.22 *supra*) Since the contractor did not have any economic interest in the clay and shale deposit, *he was not entitled to any depletion allowance at all.* This is not discrimination. The Government also refers to the sale of fire clay and shale by coal strip miners in the Brazil, Indiana, area. (See pp. 5-6 *supra*) A Congressional purpose to encourage the discovery and exploitation of natural resources is inherent in percentage depletion, and it is not inconsistent with that purpose for the taxpayer to be entitled to a larger depletion allowance for fire clay and shale which it extracted from an underground mine and which made the best sewer pipe in Indiana than a

coal strip mine owner at Brazil who sold clay as a by-product. (See pp. 68-70 *supra*)

Second, the Government asserts that the holding below will encourage "vertical integration" and that the type of integration encouraged will be "upon a most inefficient basis," since the "view adopted below rewards the manufacturer who acquires an inefficient mine." There is nothing in this Record which warrants the inference that the taxpayer's mine was inefficient. (See pp. 68-69 *supra*)

The statute as written may well encourage the development of mines which otherwise would not be developed at all, but this is most consistent with the Congressional purpose in adopting percentage depletion. Whether it will result in the merger of existing economic entities is a question which could be answered reliably, if at all, only on the basis of an extensive economic study. Since Congress has not responded to the Treasury's pleas for amendatory legislation to avoid the result reached below (pp. 96-104 *supra*), it apparently is not alarmed about any such possibility. If the "vertical integration" which the Government somberly forecasts (Br. 89-90) should begin to occur, and if Congress should desire to do so, it can change the law.

Third, the Government claims that the "possibilities" for depletion allowances are "virtually limitless." It cites as illustrations pending cases which are not before this Court; it describes the taxpayers' claims in those cases but does not analyze the facts so that this Court may consider whether those claims have any foundation under the statute as construed by the courts.

The same may be said of the Government's estimates in its petition for certiorari (pp. 7-8 and App. C), referred to again in its brief (p. 24), of the "enormous" potential impact upon the revenue. The Government's estimate of the "annual potential tax loss" (Pet. for Cert., App. C, Table II) admittedly ignores the net income limitation. More important, the estimates assume the lack of a market for all minerals in the tables before they are processed into some "manufactured product," although the applicability of the commercially marketable products rule depends entirely on the factual question of marketability.

Finally, the Government states that the administrative problems are "grave," complaining that under the decision below the Commissioner "may not determine, for each of the various segments of the mining industry, the basic mineral product which establishes the cut-off point." (Br. 24) Congress did not specify such a "basic mineral product" for each "segment of the mining industry," and as we have shown, the statutory language and legislative history make it quite clear that Congress did not intend to give the Commissioner such broad administrative discretion. As we have also shown (pp. 109-15 *supra*), the administrative problems under the Government's interpretation of the statute would be quite difficult, and the Government has given no indication of how it would solve them. Furthermore, we submit that the Government exaggerates in saying that the difficulties of determining what products each mine operator can sell on a commercial basis are so great that "the Commissioner, in most instances,

would be obliged to presume that the finished products actually manufactured by an integrated producer are the only ones which he could profitably market." (Br. 24-25) This pessimistic prediction considerably overestimates the diversity of situations which will be encountered, and it considerably underestimates the expertness, resourcefulness, and determination to protect the revenue which are characteristic of the Revenue Service.

In order to avoid the administrative problems as well as the other difficulties which the Government envisions in the commercially marketable products rule, the Government would leave to the Commissioner's discretion the determination of the "cut-off" points for various minerals. The Commissioner would then have a free hand to distinguish "mining" from "manufacturing," since the indefinite term "fit for commercial or industrial use" can provide no real standard or guide.[24] Congress specifically enacted the commercially marketable products rule because the Commissioner was making an arbitrary distinction between "mining" and "manufacturing." Congress has consistently refused to change that rule, although the Treasury has repeatedly

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[24] Even when the Treasury, in asking Congress in 1959 to abolish the commercially marketable products test, attempted to spell out in detail in its draft of legislation the processes which would be allowable in computing the depletion base, members of Congress feared that the Treasury's distinction between "mining" and "manufacturing" was too vague and granted too much power to the Commissioner (pp. 100-04 *supra*).

requested it to do so in order to restore the Commissioner's discretion.

In sum and substance, the Government now asks this Court to do what Congress has steadfastly refused to do, and this is an area which is peculiarly one for legislative judgment. *Cf. Helvering* v. *Griffiths*, 318 U.S. 371 (1943).

CONCLUSION

The judgment of the Court of Appeals should be affirmed; in the alternative, the writ of certiorari should be dismissed.

Respectfully submitted,

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May 1960.

APPENDIX I.

Internal Revenue Code of 1939:

Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. . . .

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

[26 U.S.C., 1952 Ed., Sec. 23.]

Sec. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

* * * * *

(4) [As amended by Sec. 145 of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 319 (a) of the Revenue Act of 1951, c. 521, 65 Stat. 452.] *Percent-*

age depletion for coal and metal mines and for certain other mines and natural mineral deposits.—

(A) *In general.*—The allowance for depletion under section 23 (m) in the case of the following mines and other natural deposits shall be:

(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine, 5 per centum,

(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum,

(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone, and potash, 15 per centum, and

(iv) in the case of sulfur, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the

property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

(B) [As added by Sec. 124 (c) of the Revenue Act of 1943, c. 63, 58 Stat. 26, and amended by Sec. 207 (a) of the Revenue Act of 1950, c. 994, 64 Stat. 906, and Sec. 304 (d) of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137.] *Definition of gross income from property.*—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes", as used herein, shall include the

following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 450 and 453.

* * * * *

[26 U.S.C., 1952 Ed., Sec. 114.]

Treasury Regulations 111:

Sec. 29.23 (m)-1. *Depletion of Mines, Oil and Gas Wells, Other-Natural Deposits, and Timber* . . . .

* * * * *

[As amended by T.D. 5413, 1944 CUM. BULL. 124; T.D. 5458, 1945 CUM. BULL. 45; T.D. 5461, 1945 CUM. BULL. 284; T.D. 6004, 1953-1 CUM. BULL. 45; T.D. 6031, 1953-2 CUM. BULL. 120. **Note: The matter added to the Regulation on July 14, 1953, by T.D. 6031 is italicized. The words in brackets were deleted by T.D. 6031.**]

(f) The term "gross income from the property", as used in Sections 114(b)(3) and 114(b)(4)(A) and Sections 29.23 (m)-1 to 29.23 (m)-19, inclusive, means the following:

* * * * *

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before the sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price

(as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method. For a description of transportation which is treated, for taxable years beginning after December 31, 1949, as mining, see the preceding paragraph and Section 114(b)(4)(B), as amended.

The term "ordinary treatment processes", as used herein, shall include the following:

(1) In the case of coal—cleaning, breaking, sizing, and loading for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment;

(3) In the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering (*agglomerating by in-*

cipient fusion) to bring to shipping grade and form, and loading for shipment;

(4) In the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash and *minerals* [ores] which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation, or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the *mineral* [ore]. The furnacing of quicksilver ores is included in the term "ordinary treatment processes". The following processes are not included in the term "ordinary treatment processes": electrolytic deposition, roasting, thermal or electric smelting, refining, or substantially equivalent processes.

In addition, the processes listed below are not included in the term "ordinary treatment processes" unless such processes are (i) otherwise provided for in (1), (2), (3), or (4) above; (ii) necessary or incidental to the processes provided for in (1), (2), (3), or (4) above; or (iii) necessary to bring the ores or minerals into condition or form suitable for shipment (for example, the agglomeration of concentrates):

(A) treatment effecting a chemical change;

(B) blending with other material;

(C) thermal action;

(D) fine pulverization, pressing into shape, or molding.

For the purposes of (3) and (4) above, the terms "concentration" or "concentrating" mean the process of eliminating waste or of separating two or more minerals or ores.

* * * * *

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959

UNITED STATES OF AMERICA,
Petitioner,

v.

CANNELTON SEWER PIPE COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

APPENDIX II TO BRIEF FOR THE RESPONDENT

Part A: Discussion of Treatment Processes

Part B: Cases

Part C: Legislative Materials

Part D: Miscellaneous Materials

Part E: Chart of Cases Applying the Commercially Marketable Products Rule

APPENDIX II

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APPENDIX II

Part A: Discussion of Treatment Processes

1.

Analysis of the Government's Theories of Restricted Classification of "Ordinary Treatment Processes" Under Code Section 114(b)(4)(B)

a. *The Government's attempt to restrict "ordinary treatment processes" within the meaning of Section 114(b)(4)(B) to "mineral dressing" processes for separation of the valuable constituent from waste is unsound.*

In the first place, there is no basis for the Government's suggestion that in the mining industry "treatment" is merely a synonym for "mineral dressing," a technical term relating to the separation of the valuable constituent from waste matter. For this, the Government cites two authorities, neither of which supports the idea. One is Taggart's use in his *Handbook of Mineral Dressing* of the headings "Methods of Treatment" and "Treatment" to describe the processing of various minerals, including ore and mineral dressing. (Gov't Br. 32 n.25) Taggart obviously does not confine the term "treatment" to mineral dressing, and in fact he includes a description of the processing of common clay and fire clay into brick and tile under the heading "Treatment" in his discussion of "Clay."[1] The other authority cited by the Government is Fay's *Glossary of the Mining and Mineral*

[1] TAGGART, HANDBOOK OF MINERAL DRESSING, 3-13 through 3-15 (1945 ed.) (reprinted p. 170 *infra*).

Industry, which according to the Government's brief (p. 32 n.25) contains a statement "to the effect that a treatment process in mining means a process 'whereby the valuable constituent is recovered.'" Actually, Fay defines "treatment" in *metallurgy*, not *mining*, as "the reduction of ores by any process whereby the valuable constituent is recovered."[2] That is the only kind of process involved in metallurgy as defined in the same *Glossary, i.e.*, the "science and art of preparing metals for use from their ores by separating them from mechanical mixture and chemical combination."[3]

In the second place, the processes specifically listed in the statute as included in "ordinary treatment processes" include processes which do not involve separating the valuable constituent from waste matter. Many of the listed processes are of such character, as would be expected, since such processes are necessary to obtain a marketable product from almost all metallic ores. However, the statutory definition of mining as adopted in 1943 expressly included in "ordinary treatment processes" a number of other processes which clearly are not processes for separating the valuable constituent from waste matter—for example, sizing coal and loading it for shipment, sintering iron ore and loading it for shipment, and cooling and breaking sulphur and loading it for shipment. Other processes not of that character were added to the list of included processes when the Internal Revenue Code of 1954

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[2] FAY, A GLOSSARY OF THE MINING AND MINERAL INDUSTRY 699 (U. S. Bureau of Mines, Dep't of Interior, 1947).

[3] FAY, *op. cit. supra* note 2, at 431.

was adopted—*i.e.*, the processing of coal to allay dust and prevent freezing, the pulverization of talc, and the sintering and nodulizing of phosphate rock.[4]

The Government recognizes that the listing by Congress of such processes as included in "ordinary treatment processes" refutes any contention that "ordinary treatment processes" were intended to be restricted to mineral dressing involving separation of the valuable constituent from waste matter. It concedes that putting minerals in "shipping grade or form may require, in some instances, such preparatory processes as crushing, screening, or drying" (Gov't Br. 9, 33), and it proceeds to another classification theory.

B. The Government's attempt to restrict "ordinary treatment processes" within the meaning of Section 114(b)(4)(B) to processes which are not "manufacturing" processes is also unsound.

The Government's ultimate theory of classification of the processes to which it contends "ordinary treatment processes" are restricted is on the basis of a distinction between mining processes, which it says "do not destroy the physical and chemical identity of the minerals" (Gov't Br. 9), and manufacturing processes, which it says "involve the mechanical or chemical transformation of inorganic and organic substances into new products." (Gov't Br. 9)

This attempted classification is also refuted by the processes listed in the statute as included in "ordinary

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[4] INT. REV. CODE OF 1954, § 613(c)(4)(A), (E) (p. 114 *infra*).

treatment processes." Many of the processes specifically included by the statute involve chemical changes and therefore are manufacturing processes under the Government's suggested distinction. For example, chemical changes are effected by such processes as flotation,[5] amalgamation,[6] cyanidation,[7] leaching,[8] precipitation,[9] and the furnacing of quicksilver ores.[10] All these processes are specifically included as "ordinary treatment processes" by clause (iv) of Section 114(b)(4)(B). The outstanding authority on the subject of mineral dressing considers that every mineral dressing process, whether it involves methods of separation which do not effect substantial chemical changes ("ore dressing") or utilizes chemical reaction for separation of the constituents ("extractive metallurgy"), "is to be looked upon primarily as a manu-

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[5] TAGGART, *op. cit. supra* note 1, at 12-03, 12-04, 12-84; RICHARDS & LOCKE, TEXTBOOK OF ORE DRESSING 235-36 (3d ed. 1940).

[6] TAGGART, *op. cit. supra* note 1, at 14-11; GAUDIN, PRINCIPLES OF MINERAL DRESSING 473 (1939).

[7] 6 ENCYCLOPEDIA BRITANNICA, *Cyanide Process* 914 (1956 ed.); NEWTON, INTRODUCTION TO METALLURGY 567-68 (2d ed. 1947); STOUGHTON & BUTTS, ENGINEERING METALLURGY 347 (1926).

[8] LIDDELL & DOAN, THE PRINCIPLES OF METALLURGY 8, 243-49 (1933); STOUGHTON & BUTTS, *op. cit. supra* note 7, at 65, 298-99; NEWTON, *op. cit. supra* note 7, at 557-58, 563, 564.

[9] LIDDELL & DOAN, *op. cit. supra* note 8, at 244, 261; NEWTON, *op. cit. supra* note 7, at 561, 563, 568, 573; TAGGART, HANDBOOK OF ORE DRESSING 955-56 (1927 ed.); STOUGHTON & BUTTS, *op. cit. supra* note 7, at 102-03, 300, 301, 348.

[10] 15 ENCYCLOPEDIA BRITANNICA, *Mercury* 270 (1956 ed.); STOUGHTON & BUTTS, *op. cit. supra* note 7, at 352; NEWTON, *op. cit. supra* note 7, at 535.

facturing process."[11] Thus, he would classify not only the included processes listed above which involve chemical changes but every included process listed in clause (iv) of Section 114(b)(4)(B) as a manufacturing process.

Indeed most, if not all, of the processes listed in that clause do effect a change in the physical or chemical identity of the material or both. Crushing and grinding, which are usually required as preparatory steps to concentration by physical means,[12] certainly change the physical identity of the ore.[13] The definitions of various processes set out in Appendix B to the Government's brief and the authorities there cited for these definitions show the following about other processes listed in clause (iv) of the statute as included in "ordinary treatment processes." Leaching not only effects a chemical change in the mineral but also changes its physical form from solid to liquid.

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[11] TAGGART, *op. cit. supra* note 1, at 1-01.

[12] NEWTON, *op. cit. supra* note 7, at 333-34; RICHARDS & LOCKE, *op. cit. supra* note 5, at 5, 67, 87.

[13] So does the pulverization of talc, which was added by Congress to the list of processes specifically included in "ordinary treatment processes" in enacting the Internal Revenue Code of 1954 (Section 613(c)(4)(E)) after hearing testimony from industry representatives that the Treasury Department was refusing to consider fine pulverization of talc as an ordinary treatment process although there is no market for talc until it is pulverized and although the Tax Court had rejected the Government's contention. House Hearings, 1953, pp. 2033-43 (quoted in part in Gov't App. B, pp. 310-11, 448-51). The Tax Court case referred to is *International Talc Co.*, 15 T.C. 981 (1950). The issue was decided against the Government's position again in *Townsend* v. *The Hitchcock Corp.*, 232 F.2d 444 (4th Cir. 1956).

The same is true of cyanidation. Precipitation, which follows leaching and cyanidation, changes the liquid compound chemically and physically to impure metal in solid form. Crystallization is a process of changing a liquid into a crystalline form. The furnacing of quicksilver is a distillation process involving both chemical changes and physical changes. Cinnabar ore, a solid, is heated to volatilize the mercury and the mercury vapor is then condensed into a liquid.[14] Mercury is sold in the liquid form, in flasks; there is no market for the crude cinnabar ore.[15]

Further evidence that in enacting Section 114(b)(4)(B) Congress was not trying to draw a line between "mining" and "manufacturing" based on the technical nature of the processes, but instead was establishing a practical commercially marketable products rule, is found in a comparison of certain processes expressly excluded from "ordinary treatment processes" by the statute with other processes which are expressly included in the term.

Thus, smelting is excluded, whereas leaching and cyanidation, which like smelting are metallurgical

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[14] See definitions of leaching, cyanidation, precipitation, crystallization, and furnacing of quicksilver in Gov't App. B, pp. 498-99 and authorities there cited. See also notes 7, 8, 9, 10 *supra*.

[15] New Idria Quicksilver Mining Co. v. Commissioner, 144 F.2d 918 (9th Cir. 1944); U.S. Bureau of Mines, Dep't of Interior, Bull. 556, Mineral Facts and Problems 514 (1956); House Hearings, 1942, pp. 1199, 1202 (Gov't App. B, pp. 152, 153); Silver Subcommittee Hearings, 1942, p. 762 (Gov't App. B, pp. 161-62).

processes for separating metal from the ore involving chemical changes,[16] are included. The explanation is that metallic ores which can be smelted economically can be sold in the concentrate form, before smelting or refining.[17] On the other hand, leaching is used, for example, in the case of copper ores which are of too low a grade to smelt,[18] and cyanidation is used in the case of gold ores more amenable economically to that process than to smelting;[19] therefore leaching or cyanidation may be necessary in order to obtain a commercially marketable product.

Similarly, the process of roasting, which is specifically excluded, is very similar to furnacing quicksilver ores,[20] which is specifically included; in fact, the furnacing of quicksilver ores is frequently termed "roasting."[21] The only rational explanation is that the furnacing process must be applied to quicksilver ore in

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[16] TAGGART, *op. cit. supra* note 1, at 1-01; STOUGHTON & BUTTS, *op. cit. supra* note 7, at 87, 281, 298.

[17] Joint Committee Report, 1930 (App. XXXI, Shepherd Report) pp. 69-71 (Gov't App. B, pp. 82-87); TAGGART, *op. cit. supra* note 1, at 2-254; see Gov't Br. 8.

[18] TAGGART, *op. cit. supra* note 9, at 950; see STOUGHTON & BUTTS, *op. cit. supra* note 7, at 298; U. S. BUREAU OF MINES, DEP'T OF INTERIOR, MATERIALS SURVEY: COPPER, c. II, at 57 (1952).

[19] TAGGART, *op. cit. supra* note 1, at 2-72, 2-74, 2-75.

[20] STOUGHTON & BUTTS, *op. cit. supra* note 7, at 79-80, 352.

[21] TAGGART, *op. cit. supra* note 1, at 2-206; 15 ENCYCLOPEDIA BRITANNICA, *Mercury* 270 (1956 ed.); U. S. BUREAU OF MINES, DEP'T OF INTERIOR, I. C. 7941, MERCURY 34 (1959); Silver Subcommittee Hearings, 1942, pp. 761, 762 (Gov't App. B, pp. 159, 161-62).

order to obtain a marketable product,[22] whereas ores which are roasted, principally lead, zinc and some copper ores,[23] are marketable in the concentrate stage,[24] prior to treatment by roasting.[25]

2.

Analysis of Included and Excluded Processes Showing Congress' Recognition of Different Commercially Marketable Products of the Same Mineral

Congress' recognition that "the commercially marketable mineral product or products" within the meaning of the statute may be different for miners of the same mineral is shown by the nature of certain processes which it has expressly listed in the statute as included in "ordinary treatment processes" for designated minerals and ores and certain other processes which it has excluded from the term for designated ores.

For instance, in the case of coal, Clause (i) of Section 114(b)(4)(B) includes as ordinary treatment processes "cleaning, breaking, sizing, and loading for shipment." The Government's brief, citing authorities, states (p. 29) that cleaning, breaking and sizing are necessary, *at least in the case of anthracite*, to put the coal in marketable form. In *Black Mountain Corporation*, 21 T.C. 746, 754 (1954), the Tax Court found as facts that mine operators clean all coal, size most coal, and break the "greater share of anthracite coal."

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[22] See note 15 *supra*.

[23] NEWTON, *op. cit. supra* note 7, at 476-78.

[24] TAGGART, *op. cit. supra* note 1, at 2-254, 2-255; Strauss, *Marketing of Nonferrous Metals and Ores*, in ECONOMICS OF THE MINERAL INDUSTRIES 282-83 (1959).

[25] See note 23 *supra*.

Until recent years, most of the bituminous coal purchased by railroads and many industrial users was unbroken coal in the size as mined ("mine run"), and such users still purchase mine-run coal regularly in addition to broken sizes.[26] By including all the processes listed for coal as "ordinary treatment processes," although not always necessary to make coal marketable, Congress recognized that there may be different commercially marketable products of the same class of mineral listed in the statute. Furthermore, in adopting the Internal Revenue Code of 1954, Congress added to the processes listed in the statute as "ordinary treatment processes" in the case of coal "dust allaying" and "treating to prevent freezing,"[27] after hearing testimony by a representative of the coal industry that only about 9 per cent of the total national bituminous coal production is treated to allay dust, but that practically all bituminous coal for residential heating purposes must be so treated in order to be sold, and that anti-freeze treatment is necessary in shipping coal only in the northern parts of the country during winter months.[28]

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[26] Lambur, *Coal Marketing and Trade*, in ECONOMICS OF THE MINERALS INDUSTRIES 338, 339-40, 341 (1959).

[27] INT. REV. CODE OF 1954, § 613(c)(4)(A) (p. 114 *infra*).

[28] Senate Hearings, 1954, pp. 1409-18 (quoted in part in Gov't App. B, pp. 342-48). The coal industry representative, in asking the Senate Finance Committee to make these amendments, explained that the Tax Court had held in *Black Mountain Corporation*, 21 T.C. 746 (1954), that oil treatment to allay dust was not an ordinary treatment process. The Tax Court found that untreated coal was the first commercially marketable product of the taxpayer, a coal mining company which sold the larger portion of its output for industrial purposes without such treatment.

Furthermore, the statute expressly includes as "ordinary treatment processes," in the case of gold, copper, and other ores not customarily sold in the form of a crude mineral product, amalgamation, cyanidation, and leaching, but provides that smelting of such ores is not included as an ordinary treatment process. Amalgamation or cyanidation, or a combination of these processes, yields gold bullion from gold ores amenable to such processes.[29] On the other hand, some gold ores are smelted; and in such cases, ore concentrate is the product which goes to the smelter.[30] Gold bullion is a different, more processed product than gold ore concentrate.[31] Yet the statute clearly contemplates that in some cases the commercially marketable product of gold ore is gold bullion since amalgamation and cyanidation are "ordinary treatment processes," and that in other cases the commercially marketable product of gold ore is the ore concentrate, since smelting is not an "ordinary treatment process."

Similarly, copper ores, depending upon their grade and type, are either smelted or leached.[32] Leaching is used in the case of copper ores which, because of their grade or type, cannot be smelted economically,[33] and it

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[29] TAGGART, *op. cit. supra* note 1, at 2-74 (reprinted pp. 166-70 *infra*); GAUDIN, *op. cit. supra* note 6, at 477; RICHARDS & LOCKE, *op. cit. supra* note 5, at 280.

[30] TAGGART, *op. cit. supra* note 1, at 2-72; RICHARDS & LOCKE, *op. cit. supra* note 5, at 209; STRAUSS, *Marketing of Nonferrous Metals and Ores, op. cit. supra* note 24, at 294.

[31] TAGGART, *op. cit. supra* note 1, at 2-74 (p. 167 *infra*); Silver Subcommittee Hearings, 1942, p. 736 (Gov't App. B, pp. 154-55).

[32] STOUGHTON & BUTTS, *op. cit supra* note 7, at 280-81, 298.

[33] See note 18 *supra*.

yields impure copper.[34] The statute clearly contemplates that, if copper ore is smelted, the ore concentrate is the commercially marketable product since "smelting" is excluded from "ordinary treatment processes." On the other hand, if the ore must be leached in order to obtain a commercially salable product, the leaching is an ordinary treatment process and the commercially marketable product is the impure copper.

Part B: Cases

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 5186

DRAGON CEMENT COMPANY, INC., *Plaintiff, Appellant,*

v.

UNITED STATES OF AMERICA, *Defendant, Appellee.*

Appeal from the United States District Court for the District of Maine

Before MAGRUDER, *Chief Judge*, and WOODBURY and HARTIGAN, *Circuit Judges*

Opinion of the Court

[244 F. 2d 513]

May 14, 1957

MAGRUDER, *Chief Judge.* Appellant, a Maine corporation, in its capacity as successor (by merger effective November 30, 1951) to Lawrence Portland Ce-

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[34] STOUGHTON & BUTTS, *op. cit. supra* note 7, at 299-301.

ment Company, a Pennsylvania corporation, brought this action in the United States District Court for the District of Maine seeking recovery of federal income and excess profits taxes for the period January 1 to November 30, 1951, in the amount of $483,522.19, with interest. The facts were not in dispute and were recited in a stipulation. Both parties having moved for summary judgment, the district court on September 24, 1956, entered a judgment the first paragraph of which (as subsequently amended) decreed that the plaintiff recover of the defendant the sum of $10,546.46, with interest, on account of a deductible tax loss under § 23(f) of the Internal Revenue Code of 1939, an issue which is no longer in the case, and the second paragraph of which decreed as follows:

> "2. That plaintiff take nothing further in consequence of plaintiff's complaint as to the issue of percentage depletion and as to that issue, the action be and it is hereby dismissed on the merits."

The taxpayer has appealed from that portion of the judgment denying recovery to it under the percentage depletion issue, so that the case now before us turns solely on a question of statutory interpretation of § 114(b)(4)(B) of the 1939 Code, as amended, which defines the term "gross income from mining" for use in determining the basis for percentage depletion allowed as a deduction from income derived from certain mines and natural mineral deposits.

The allowance for depletion has been a controversial subject for years, and officials of the executive branch

have sought from time to time, with conspicuous lack of success, to persuade the Congress to eliminate some of its alleged overgenerous features. See Mertens, Law of Federal Income Taxation § 24.04 (1954). We are not concerned with the wisdom or policy of the statutory allowance, once we are sure what the allowance is, for it is plainly our judicial function merely to apply the allowance as Congress wrote it and meant it.

The need for and fairness of some allowance for depletion proceeds from the fact that the production of income through the exploitation of natural resources is accompanied by an inevitable consumption of capital in the form of the gradual exhaustion of the natural resource being exploited. Thus the allowance serves to offset the injustice of classifying only as income what might be regarded as income commingled with return of capital, and serves also as an incentive to encourage capital expenditures in the direction of discovery and exploitation of natural resources.

Of the three types of depletion allowance prescribed at various times by the Congress, percentage depletion (with which we are now concerned) is to be contrasted with cost depletion and discovery depletion. Cost depletion, based upon the cost to the taxpayer of the particular deposit, seeks to return to the taxpayer free of tax that portion of his cost attributable to the amount of the deposit used up in earning the income on which he is taxed during a given taxable year. Discovery depletion seeks to reward the taxpayer for the discovery of unknown natural deposits, and has

usually been based upon the fair market value of the deposit within thirty days after the date of its discovery. By the third type of depletion allowance, percentage depletion, the Congress hoped to furnish an easily computable allowance that would avoid many of the complications arising in connection with the computation of cost or discovery depletion. Percentage depletion is based upon a fixed percentage of the income realized during the taxable year from the exploitation of a piece of property—the percentage varying, somewhat arbitrarily, depending upon the kind of deposit involved.

With the gradual enlargement of the categories of mineral properties to which the percentage depletion became applicable, the Congress has at the same time automatically eliminated discovery depletion in respect to such deposits.[1] In general, percentage depletion has remained as an alternative to cost depletion, so that even if the taxpayer fails to establish the cost of the property, he nevertheless may be entitled to the allowance of a percentage depletion. It is also true, as pointed out in Mertens, Law of Federal Income Taxation § 24.31a (1954), "that through percentage depletion a taxpayer may recover more than his cost over the life of the property."

For present purposes we need go no further back than to the provisions of the Internal Revenue Code of 1939.

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[1] The 1954 Code has now abolished discovery depletion entirely as applied to future years.

Section 23 of this Code contained the following (53 Stat. 12, 14):

"Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions: . . .

(m) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. . . .

(n) Basis for Depreciation and Depletion.—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114."

Section 114(b)(1) stated as the general rule (53 Stat. 45) that the basis for the depletion allowance should be the adjusted basis in § 113(b) for determining gain upon the sale or other disposition of such property, except as otherwise provided in the ensuing paragraphs numbered (2), (3), and (4). Paragraph (2) related to discovery value in the case of certain mines. Paragraph (3) gave a percentage depletion formula for oil and gas wells. Paragraph (4) gave percentage depletion formulas for coal, metal, and sulphur mines (but not including the type of deposit

involved in the case at bar), and provided allowances based upon a prescribed percentage of the "gross income from the property during the taxable year".

The phrase "gross income from the property" was undefined as it appeaed in the 1939 Code. It thus had a lurking ambiguity where the mine owner customarily performed more than merely extractive operations before realizing any income; in such cases, would the basis for the depletion allowance include gross income from what in other contexts might be described as manufacturing operations upon the extracted property? The statute did not make this point clear, and Regulations 111, as originally issued, naturally sought to narrow the scope of the allowance.

In the Revenue Act of 1943 (58 Stat. 45), the Congress attempted to resolve this ambiguity by inserting a definition of "gross income from the property" in a new § 114(b)(4)(B), reading in part as follows:

> "(B) Definition of Gross Income From Property.—As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commecially marketable mineral product or products. The term 'ordinary treatment processes', as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of

sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores."

It is apparent that the Congress intended not to limit the computation of the percentage depletion allowance to the gross income attributable to purely extractive processes, for the deposit when thus first extracted might not be in a commercially marketable form, and might require further processing. Congress accomplished this by providing for the first time a general formula, and by giving nonexclusive illustrations of processes included in the phrase "ordinary treatment processes". See § 3797(b) of the Code of 1939, 53 Stat. 470. The general formula, which of

course is controlling, is that the basis for computing the percentage depletion allowance shall be the "gross income from mining", defined as including "not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commecially marketable mineral product or products." Thus we must look to see what processing is normally undertaken by a mine owner or operator in order to obtain a commercially marketable product, and when such a salable product is obtained, then the gross income from the sale of such product is the base upon which to apply the percentage depletion allowance. That these "ordinary treatment processes" are not necessarily limited to those processes which leave the extracted deposit in its natural state is clear from the inclusion, as in illustration in § 114(b)(4)(B), of the process of furnacing quicksilver ores, which involves a chemical change.

It would also be helpful, in a preliminary way, to observe that the depletion allowance is not an allowance upon any *process,* whether a mining process or a manufacturing process. Nor is it an allowance, as such, upon any product. Instead, it is an allowance to the mine owner designed as a simple means to diminish his taxable income from the exploitation of a natural resource which is necessarily exhausted in the process. In making this allowance, the Congress has elected not to limit the deduction in all cases to the taxpayer's actual cost or other basis in the land from which the ore or mineral is extracted. To supply a simpler rule, the Congress has turned more and more

to the method of percentage depletion, which differs from both cost and discovery value depletion in that it is measured by an arbitrary percentage of gross income from the property, without regard to the taxpayer's cost or discovery value.

From the foregoing it is clear that by the enactment of 1943 the Congress for the first time introduced into the statute key language which had not theretofore appeared either in the statute or in the regulations thereunder, namely, a new definition of "gross income from mining" as including "not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." Notwithstanding this, the Commissioner has subsequently sought, by regulatory amendments to § 29.23 (m)-1(f) of Treas. Reg. 111, in cases where the mine owner customarily had to indulge in further processing other than merely extractive operations before obtaining a commercially marketable product upon which he could realize any income, to prescribe a relatively complex mathematical method for calculating the percentage depletion base. This would require an allocation of income derived from the sale of the first marketable product to the various treatment processes in proportion to their cost, with only those processes allowed as part of the base which occurred before any chemical change had taken place in the extracted mineral.

By § 319 of the Revenue Act of 1951 (65 Stat. 497), the Congress amended § 114(b)(4)(A) of the Internal

Revenue Code so as to extend the availability of percentage depletion for the first time to "calcium carbonates," which includes deposits of cement rock, the natural resource involved in the case at bar. The prescribed percentage for calcium carbonates was ten per cent of the gross income from mining the deposit.

With the foregoing stated by way of background, it will perhaps be easier to understand the significance of the facts in the present case.

Throughout the tax period in question, Lawrence Portland Cement Company, the taxpayer-appellant's predecessor, owned and operated two quarries, one in Maine and the other in Pennsylvania, from which it extracted cement rock, a calcium carbonate suitable for conversion into cement. The operations began with drilling and primary blasting from the face of the quarry by the open pit method to obtain the cement rock, which was then broken into manageable size by secondary blasting and loaded by shovels into dump trucks which carried it to an inclined railway where it was deposited into dump rail cars for transportation to the near-by plant.

Treatment or "beneficiation" then occurred at the plant in the following processes: The dump rail cars deposited the cement rock into a large primary crusher, which reduced the size of the extracted rock to pieces with a maximum dimension of about eight inches. After this primary crushing, the cement rock fell onto a conveyor belt which carried it to a secondary crusher which further reduced the size of the rock. From the secondary crusher a conveyor belt carried the cement rock to a shed, from which it was picked up by an over-

head crane which deposited the desired quantities into a hopper, over which a coarse bar grate was fitted to screen the crushed cement rock. From the hopper, the screened cement rock was gravity-fed to a ball mill where it was ground with water to a proper fineness known as "slurry," which was then conveyed to a wet "slurry" tank where it was kept in suspension by a revolving paddle mechanism. The "slurry" was then run off to filters where much of the water was removed, and the resulting filter cake was thereafter conveyed by belt to rotary kilns.

There is no dispute that the gross income allocable to the operations thus far described may be included in determining the gross income from mining of the mineral, cement rock, for the purpose of calculating the base to which the allowable percentage depletion is to be applied. But it was found as a fact by the trial court, and we understand that this is not controverted by the government, that except in negligible amounts, which may be disregarded, "there is no commercial market for cement rock. The first commercially marketable product is cement. The methods used by taxpayer to transform cement rock into cement are admitted to be the 'ordinary treatment processes normally applied by mine owners or operators' who produce cement."

Accordingly, the taxpayer's predecessor had to engage in further processes before obtaining a marketable product, cement, upon which gross income could be realized. The so-called filter cake was run into the upper end of rotary kilns, which were in the form of long rotating cylinders set at slight inclination, the

filter cake gradually traveling toward the lower end of the kiln. Hot gases from a flame at the lower end evaporated the water from the filter cake and burned the remaining material to a dense clinker. The clinker was then conveyed to a grinding mill where it was ground to the fineness of cement; the cement was finally placed in silos from which it was loaded and shipped in bags or in bulk. It is conceded that these last processes effected a chemical change in the cement rock, transforming it from its crude mineral state into cement, which is synthetic and not a mineral.

The dispute here involves the propriety of including income allocable to the kiln and post-kiln processes in gross income from mining, as defined; if such processes are excluded, the depletion allowance for the taxable period would be $204,859.19, whereas, if such processes are included, the allowable depletion would be $795,852.60.

It is contended by the government that mining terminated, and that the depletion base was arrived at, when the mine operator had prepared the cement rock for conversion, and that the subsequent operations, during which it underwent a chemical change and ceased to be a mineral, constituted a manufacturing process, not allowable in computing the depletion base. As indicated above, this contention is fully supported by Treas. Reg. 111, § 29.23(m)-1(f), but the taxpayer maintains that the regulation is invalid in this respect because the definition of "gross income from mining", inserted in § 114(b)(4)(B) in 1943, does not permit such an interpretation, but on the contrary compels the opposite result. Although the district court up-

held the government's view, we find ourselves in agreement with the taxpayer.

Preliminary to upholding the government's asserted interpretation, the district court concluded that the statutory language, "commercially marketable mineral product or products", was intrinsically ambiguous. One possibility, the district court said, was to construe the phrase as permitting the depletion allowance to extend to a product of a mineral, although the end product may be a synthetic non-mineral (*viz.*, a commercially marketable mineral *product*). The second possibility, said the district court, was to construe the statutory phrase as restricting the depletion allowance to products still in a mineral state (*viz.*, a commercially marketable *mineral* product).

We are unable to perceive that the statutory language contains any such inherent ambiguity. In this connection it should be observed that three other courts of appeals which have had occasion to weigh the government's arguments advanced in the case at bar, and to construe the critical statutory phrase, have held it to be "clear and unambiguous" in favor of the taxpayer's interpretation. See *United States* v. *Cherokee Brick & Tile Co.*, 218 F.2d 424, 425 (C.A. 5th, 1955); *Townsend* v. *The Hitchcock Corp.*, 232 F.2d 444, 446 (C.A. 4th, 1956); *United States* v. *Sapulpa Brick & Tile Corp.*, 239 F.2d 694, 697 (C.A. 10th, 1956). We are not persuaded that we ought to create a conflict with our brethren in other courts of appeals with respect to this matter.

In the first place it should be noted that cement has been consistently classified as a "mineral product"

both in scholarly compilations of a general sort, such as the Encyclopedia Britannica,[2] and in publications of specialized government agencies which compile information and statistics on the mining industry. Such classification has been made by the Bureau of Mines and the Bureau of the Census, both of which had listed cement as a "mineral product" at the time the statutory definition of "gross income from property" was enacted in the Revenue Act of 1943,[3] and this classification has been continued in the latest publications of these agencies.[4]

Furthermore, it is well known that the word "mineral" is frequently used before other words to describe products which are manufactured from minerals but which are not themselves composed of minerals in the natural state. In such usage it qualifies the noun which follows and indicates mineral origin; for example, "mineral wool" is a generic term which can be applied to various insulation products manufactured from minerals.[5] The dictionary furnishes many similar examples.[6]

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[2] 22 Encyc. Britannica 753, Table XIII (1954).

[3] Minerals Yearbook for 1942, pp. 38, 45, 48 (1943); Statistical Abstract of the United States, 1942, p. 845. In addition, the Statistical Abstract statistics as to production of cement (pp. 879, 888) appear in a section entitled "Mining and Mineral Products."

[4] Minerals Yearbook for 1953, vol. 1, p. 20 (1956); Statistical Abstract of the United States, 1956, pp. 732, 743.

[5] 9 Kirk & Othmer, Encyc. of Chemical Technology 122 (1952).

[6] *E.g.*, *mineral oil*, "Any oil of mineral origin, as petroleum, shale oil, or any oil *obtained from them by refining*"; *mineral water*, "Any water naturally or *artificially* impregnated with mineral salts or gases"; *mineral jelly*, a "semisolid substance *from petro-*

The legislative history of § 114(b)(4)(B) provides additional support for the interpretation of the statutory definition which we, along with other courts of appeals, have adopted. In order to support its conclusion that cement is not a "mineral product" within the meaning of the statutory definition, the district court seized upon the word "mineral" as the crucial word in the phrase "the commercially marketable mineral product or products." However, that "mineral" is not the crucial word is made clear by the Senate Finance Committee Report which explained the meaning of the section added by that committee to the Revenue Act of 1943:

> "The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a *marketable product* should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines." (Italics added.) Sen. Rep. No. 627, 78th Cong., 1st Sess., 23, 1944 Cum. Bull. 991.

In other words, although the draft of the bill to which the above report referred contained the word "mineral" and the phrase was in the same form as in the final Act, the committee did not even use the word

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leum . . . used as a stabilizer in explosives"; *mineral spirits*, a "volatile petroleum product, intermediate between gasoline and kerosene, used extensively as a thinner for paints and varnishes"; *mineral rubber*, which includes "an asphalt *artificially* obtained or treated." (Italics added.) Webster's New International Dictionary, Unabridged (2d ed. 1953).

"mineral" in explaining that the purpose of the statutory provision was to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, as defined.

Nor can we accept the government's contention that the Congress in 1943 was concerned solely with making clear that concentration processes, equivalent to those which had previously been listed in the applicable regulations, were intended to be included as a part of the mining operation, for in defining "gross income from mining," the Congress introduced new language which had never previously appeared in the history of the depletion allowance. Furthermore, the Senate Finance Committee Report which explained the provision gave no hint that Congress intended only to include such "equivalent concentration processes". Quite the contrary, as the previous quotation shows, the committee report stated that the purpose of the new provision was "to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation".[7]

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[7] It should also be observed that the government's position is subject to the anomaly that under its interpretation there never is a "commercially marketable mineral product" obtained from cement rock. Thus, to be perfectly consistent, "mining" under § 114 (b) (4) (B) would not include any "ordinary treatment processes" applied to cement rock, since mining includes only "ordinary treatment processes" applied to obtain the "commercially marketable product or products."

For the reasons above indicated, we conclude that the taxpayer is entitled to a percentage depletion deduction based upon its gross income from cement, as the first commercially marketable mineral product obtained from the deposit, calcium carbonate, after the ordinary treatment processes normally applied by such mine owners. To the extent that § 29.23(m)-1(f) of Treas. Reg. 111 is inconsistent with this conclusion, it must be declared to be invalid. See *Manhattan General Equipment Co.* v. *Commissioner*, 297 U.S. 129, 134 (1936).

A judgment will be entered vacating that portion of the judgment of the District Court now under review, and remanding the case to the District Court for further proceedings not inconsistent with this opinion.

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 16,093

COMMISSIONER OF INTERNAL REVENUE, *Petitioner.*

v.

IOWA LIMESTONE COMPANY, *Respondent.*

Petition to Review Decision of the Tax Court of the United States

[269 F.2d 398]

(July 10, 1959.)

BEFORE SANBORN, VOGEL, and VAN OOSTERHOUT, *Circuit Judges*

VAN OOSTERHOUT, *Circuit Judge.*

The Commissioner of Internal Revenue has filed timely petition for review of the decision of the Tax Court (opinion reported 28 T. C. 881) rejecting his contention that the taxpayer owes additional income tax for the years 1950[1] and 1951 by reason of claiming more percentage depletion than it was entitled to under section 114(b)(4) of the Internal Revenue Code of 1939.[2]

The principal question presented is the amount of

[1] The 1950 tax is involved only by virtue of an unused excess profits tax credit carryback from 1951.

[2] All statutory references in this opinion are to the Internal Revenue Code of 1939, as amended.

percentage depletion allowable to the taxpayer upon the pulverized chemical grade limestone it mines and processes. More particularly, the problem is the product base upon which the percentage depletion is to be computed. The Commissioner contends the depletion must be computed upon a base measured by the gross income from crushed limestone. Taxpayer contends that it is entitled to compute its depletion upon the basis of its gross income from pulverized chemical grade limestone, which it contends is its first commercially marketable product.

The Tax Court, after hearing the evidence, made findings of fact as follows:

> "The first commercially marketable product produced by petitioner from its limestone was finely ground or pulverized calcium carbonate, at least 95 per cent pure, free from toxic impurities, and containing not more than one per cent moisture.
>
> "The processes of original quarrying, crushing, heat treatment to remove moisture, and pulverization, which petitioner applied to arrive at its product, were ordinary treatment processes normally applied by mine owners to obtain the commercially marketable product."

Based upon such finding, the Court determined that the taxpayer was entitled to compute its percentage depletion upon the basis of gross income derived from its finished product, except for the cost of chemicals added and the cost of bagging, which costs taxpayer had deducted from gross income in establishing its base for percentage depletion.

There is no real dispute as to the pertinent facts. Taxpayer is an Iowa corporation engaged in the business of quarrying and processing chemical grade limestone. The quarry is located at Alden, Iowa. The processing plant is adjacent to the quarry. Taxpayer's limestone has a calcium carbonate content of over 95 per cent with a low percentage of impurities. It qualifies as chemical grade limestone.[3] The Tax Court in its opinion states:

> "Dr. H. Garland Hershey, Director and State Geologist of the Iowa Geological Survey, in a report dated December 11, 1953, stated that petitioners' limestone had the highest percentage of calcium carbonate and the lowest impurity content of any limestone tested, except one near Gilmore City, Iowa, and is available near the surface over a very small area as compared to the total exposed area of all other limestone in Iowa."

In the midwest there are more than a thousand quarries producing agricultural limestone and about six hundred producing stone used for building and road purposes, but there are less than a dozen quarries producing chemical grade limestone.

The Tax Court fairly summarized taxpayer's method of producing its product, as follows:

> "The processes employed by petitioner consist of stripping the overburden, and blasting the face of the quarry with explosives in drill holes. The

[3] At the trial an issue was raised as to whether taxpayer's stone was chemical grade limestone. The Commissioner in his brief specifically states that he does not contest the Tax Court's finding that taxpayer's limestone is chemical grade limestone.

broken limestone is loaded in trucks and hauled to the primary crusher which reduces it to varying sizes from a tennis ball to a football or basketball. The large pieces are carried into the plant where a secondary crushing in hammer mills takes place. The limestone is then conveyed into roller mills which process the material, and the moisture is removed by hot air from furnaces being forced through the roller mills. The limestone is drawn by air stream from the top of the roller mills by a series of collectors. Part of the finely processed limestone is treated with chemicals, such as iodine, upon specifications of particular customers. Both the chemically treated and untreated pulverized limestone is packaged in 50 and 100 pound paper bags. A part of the processed product is shipped in bulk by loading in tank cars on petitioner's spur track. The introduction of air, heated to about 400 degrees, merely removes the moisture and does not cause any chemical change."

The taxpayer's plant was constructed to produce pulverized chemical grade limestone. The stone at the time it enters taxpayer's plant after primary crushing is not commercially marketable for any purpose. There is no place in the plant where the material can be withdrawn after it has started its journey through the plant. Samples taken after the hammer mill operation in the plant indicate that the stone is not sufficiently crushed at that stage to be commercially marketable for any purpose. The available market for taxpayer's product is feed and mineral manufacturers. All purchasers in-

sist that the stone be finely ground, contain at least 95 per cent of calcium carbonate, be free from toxic impurities, and contain less than 1 per cent moisture. There is no demand for chemical grade limestone for chemical purposes except in the fully processed finely ground form produced by the taxpayer.

All of the taxpayer's product, except an insignificant amount of dirty, contaminated stone, sold to a county for road purposes, was sold in its fully processed form. There is a market for limestone for road rock and agricultural purposes in a crushed form, but there is no demand for chemical grade limestone in that form. While taxpayer's plant as constructed does not produce limestone satisfactorily crushed for road or agricultural purposes, the plant could be converted to do such crushing.

The right of the taxpayer to a percentage depletion allowance is unchallenged. The depletion allowance is a matter of legislative grace. The deduction is intended as compensation for capital assets consumed in the production of income through the severance of minerals. *Anderson* v. *Helvering*, 310 U.S. 404. An interesting discussion of the purpose and development of the percentage depletion legislation is found in *Dragon Cement Company* v. *United States*, 1 Cir., 244 F.2d 513. The scope of the depletion deduction is governed solely by the statutes authorizing the deduction. Our problem is largely one of statutory interpretation. We now look to the controlling statutes.

Section 23(m) authorizes the deduction from gross income from mining of "a reasonable allowance for depletion * * * according to the peculiar conditions in

each case * * *." The statutory provision authorizing percentage depletion for minerals is section 114(b)(4), which reads in part:

> "* * * *Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.*
>
> "(A) *In general.* The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—
>
> * * * * *
>
> "(iii) in the case of * * * chemical grade limestone * * * 15 per centum,
>
> * * * * *
>
> of the gross income from the property during the taxable year * * *."

Section 114(b)(4)(B) defines "gross income from property" as being "gross income from mining," and defines the word "mining" as used therein "to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products". As to some ores and minerals the statute describes ordinary treatment processes, but such processes are not enumerated with reference to chemical grade limestone and many other minerals.

In the *Dragon Cement Company* case, *supra*, the court points out that section 114(b)(4)(B) lays down the formula which provides that "the basis for computing

the percentage depletion allowance shall be the 'gross income from mining', defined as including 'not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products.'" With reference to the application of the formula, the court states (p. 516 of 244 F.2d):

> "* * * Thus we must look to see what processing is normally undertaken by a mine owner or operator in order to obtain a commercially marketable product, and when such a salable product is obtained, then the gross income from the sale of such product is the base upon which to apply the percentage depletion allowance. That these 'ordinary treatment processes' are not necessarily limited to those processes which leave the extracted deposit in its natural state is clear from the inclusion, as an illustration in § 114(b)(4)(B), of the process of furnacing quicksilver ores, which involves a chemical change."

Courts in interpreting section 114(b)(4)(B) have uniformly held that the formula prescribed by the statute is clear and unambiguous, and that the depletion base to be used is the sale price of the first commercially marketable mineral product or products, provided that the processes applied, which are of a manufacturing nature rather than a mining nature, are the processes normally applied by mine owners to obtain the commercially marketable product. Thus, in *Cannelton Sewer Pipe Co.* v. *United States*, 7 Cir., 268 F.2d

334, decided June 15, 1959; *United States* v. *Sapulpa Brick and Tile Corporation*, 10 Cir., 239 F.2d 694, and *United States* v. *Cherokee Brick & Tile Co.*, 5 Cir., 218 F.2d 424, it was held that brick and tile were the first commercially marketable products from clay and shale mines. *Dragon Cement Co., supra,* holds manufactured cement is the first commercially marketable product from cement rock. *New Idria Quicksilver Mining Co.* v. *Commissioner of Internal Revenue*, 9 Cir., 144 F.2d 918, holds that mercury is the first commercially marketable product from cinnabar. *Centropolis Crusher Co.* v. *Bookwalter*, W.D. Mo., 168 F.Supp. 33, a case factually very similar to our present case, holds that finely crushed and ground limestone in eight different graded sizes is a first commercially marketable product from chemical grade limestone. *Riverton Lime and Stone Co.* v. *Commissioner of Internal Revenue*, 28 T.C. 446, holds that hydrated hydraulic lime, which sold for $19.20 per ton, is the first commercially marketable product from the limestone mine, although there was demand for agricultural limestone in the vicinity of the mine.

In many of the cases just cited the Commissioner had urged that the manufacturing processes could not constitute part of the "ordinary treatment processes." The Commissioner does not make such argument here, but states that the cases just discussed are not controlling because in most of said cases the Government conceded that the product of the mine before the manufacture stage was not commercially marketable. In our present case, the Government strongly urges that crushed limestone after the hammer mill process and before pulverization is commercially marketable for

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road or agricultural purposes. A similar argument was made to the Seventh Circuit in the *Cannelton Sewer Pipe Co.* case, *supra*, and was rejected. In that case the minerals were clay and shale. While the evidence showed that there was a market for these products, the court found that the price that the taxpayer could get for its clay and shale would be less than its production costs, and hence concluded the clay and shale were not commercially marketable. The court states:

> "We agree with the taxpayer that it did not have a *commercially* marketable product in its fire clay and shale. We are unable to accept the theory that a taxpayer's depletion allowance is to be computed on the basis of a representative market or field price for a product which taxpayer could not sell at a profit. To do so would be to deprive of all meaning the words 'commercially marketable' as used in the Code provision here considered. The integrated operations of taxpayer in this case (that is, combined mining and manufacture) were certainly not unique. The evidence the Government used to establish the existence of a market for taxpayer's fire clay indicates, in fact, that the integrated miner-manufacturer was the rule rather than the exception in Indiana, in 1951. The fact that certain operators of strip mines found it economically feasible to extract and sell fire clay primarily in a limited area near Brazil, Indiana does not alter this picture. Finally, there is no contention that taxpayer applied other than ordinary treatment processes in obtaining its finished products."

In *Sparta Ceramic Company* v. *United States*, N.D. Ohio, 168 F.Supp. 401, 404, the court discusses and defines "commercially marketable" as follows:

"Taxpayer equates 'commercially marketable' with 'economically feasible', and adopts the view that before a product is commercially marketable there must be the prospect of substantial sales with the possibility of a profit being made thereby.

"The Government's theory on the definition of this term is that it means only salable or fit to be offered for sale in business intercourse.

"Both logic and the decided cases support the taxpayer's interpretation.

"Webster's New International Dictionary (2nd Ed.) defines 'commercial' as:

"'1. Of or pertaining to commerce * * *

"'2. Having financial profit as the primary aim'.

"'Marketable' is defined as:

"'1. Fit to be offered for sale in a market; * * *

"'2. Wanted by purchasers, saleable; * * *'

"Thus, 'marketable' can be said to be 'saleable, or fit to be offered for sale in a market', which is exactly the definition the Government wishes to ascribe to 'commercially marketable'. The fallacy of this desired interpretation is the failure to include the profit making aspect, 'commercial'."

In *Riverton Lime & Stone Co.* v. *Commissioner of Internal Revenue, supra,* the Tax Court states (p. 452 of 28 T.C.):

> "* * * We think 'commercially marketable' means that there is commerce or trade in a mineral product and that there is an established market in which such product is sold. Here there was neither so far as this particular crushed limestone was concerned. But, even in the face of those facts, the respondent argues that because the crushed stone which the petitioner produced *could* have been used for agricultural purposes, it must compute its allowable depletion on the theoretical gross income supposedly derived from the sale of the crushed stone. It seems to us that the effect of that argument is to read the words 'commercially marketable' out of the statute."

We believe that the profit-making aspect must be given consideration in determining whether a mineral product is commercially marketable. As previously stated, taxpayer had a relatively rare and special type of limestone suitable for chemical use. It had the right to market its chemical grade limestone for the purpose for which it was most suited and in a field where it would command a fair price. Gold, silver, and iron ores and other valuable minerals could doubtless be sold for road rock, fill, or ballast, but no one would contend that their value must be determined upon such a limited use of such products. It was not economically feasible for the taxpayer to market its superior stone as ordinary road rock. Many kinds of cheap stone would equally serve such a purpose.

The Government also contends that the only relevant product of any mining industry in which a taxpayer is engaged is the first commercially marketable product of that industry, and that such product in the limestone field is crushed limestone, regardless of the use to which the stone may be put. This argument was properly rejected by the Tax Court. In response to a similar argument, the Seventh Circuit in *Cannelton Sewer Pipe Co., supra,* states:

> "* * * The short answer to this is that we do not agree that it was intended that the depletion allowance for each mineral be reduced to the common denominator represented by a conceivable product most cheaply produced from each mineral. In *United States* v. *Cherokee Brick & Tile Company, supra,* and *United States* v. *Sapulpa Brick and Tile Corporation, supra,* the Fifth and Tenth Circuits, respectively, allowed depletion on both *brick* and *tile.* In *Townsend* v. *The Hitchcock Corporation, supra,* both *talc powder* and *talc crayons* were treated as depletable products."

We believe that the conclusion reached by the Seventh Circuit is supported by the authorities it cites, and that the court properly interpreted the depletion statute.

We do not think that the depletion statute contemplates that all types of limestone be considered the same mineral. This was apparently the Tax Court's thought when it stated:

> "Limestone is divided commercially into three large fields, i. e., chemical and manufacturing

industries, building industries, and agriculture * * * "

The foregoing statement is fully supported by the evidence. Chemical grade limestone must meet rigid specifications. A very small proportion of limestone meets such specifications. Specifications for agricultural and building stone are much less exacting. Section 114(b) gives different treatment to various types of limestone. Limestone used for building is classified as stone and is given a 5 per cent depletion rate (§ 114(b)(4)(A)(i)); calcium carbonate carries a 10 per cent rate (§ 114(b)(4)(A)(ii)); and chemical grade limestone carries a 15 per cent rate (§ 114(b)(4)(A)(iii)).

Section 39.23(m)-5(b), Regulations 118,[4] provides in part:

"§ 39.23(m)-5. Computation of depletion based on percentage of income in case of certain mines or other natural deposits.

* * * * *

"(b) For the purposes of this section, the minerals indicated below shall have the following meanings:

* * * * *

Calcium carbonate * * * Miscellaneous limestones and other calcium carbonate rocks (not specifically

[4] Regulations 118 are effective only to taxable years commencing after December 31, 1951, and were not in effect for the taxable years here involved. The regulations, however, interpret the same section of the Internal Revenue Code of 1939 we are here considering.

provided for at a 5 percent or 15 percent rate of percentage allowance) such as cement rock and limestone used or sold for use in soil treatment. This classification does not include rock or minerals used or sold for use as ballast, road making, concrete aggregates, or other purposes for which chemical composition is not a major requirement.

* * * * *

Limestone, chemical grade * * * Limestone used or sold for use in the chemical trades."

The record shows that crushed limestone used for agricultural and road purposes brings $1.35 to $1.75 per ton. The Government contends the taxpayer gets $9.00 per ton for its product. Thus, it would appear that the taxpayer receives some five times as much for its finished product as it would have received if it had sold it in a crushed stage. The breakdown on the increased cost of processing the stone from the crushed stage to the pulverized stage is not readily ascertainable from the record. It is, however, clearly apparent that the increased cost of the additional processing represents only a minor fraction of the higher price received by the taxpayer for its product. The greater part of the higher price received appears to be attributable to the superior quality and relative scarcity of the chemical grade limestone. We find nothing in the percentage depletion statute which compels the conclusion that the depletion base for the taxpayer is limited to the gross income that would have been produced by the sale of the crushed product of an inferior and more

plentiful limestone which is not adaptable to chemical uses.

The Commissioner also argues that to give the taxpayer a greater depletion base than owners of inferior limestone quarries would be inequitable. At least as good an argument can be made that it would be unfair to the taxpayer not to allow it depletion based upon the reasonable consideration of the value of its depletable product. However, such arguments have no weight either way as the depletion base is controlled entirely by the statute. Any inequities call for legislative rather than judicial action.

The Commissioner expresses some fear that the logical result of the Tax Court's holding is that a miner can use as his depletion base the gross sale price of any product he chooses to manufacture. Such fear is without foundation. The depletion statute as interpreted by the Tax Court limits the depletion allowance to the first commercially marketable chemical grade limestone produced. This is manifest by the court's determination that the costs of bagging and chemical additive should be excluded in computing the depletion base. For depletion purposes the product may not be processed beyond the stage where it becomes a commercially marketable product. *Cannelton Sewer Pipe Co.* v. *United States, supra; Sparta Ceramic Company* v. *United States, supra.*

The evidence fully supports the fact findings of the Tax Court that the first commercially marketable product in the chemical grade limestone field is the finely ground limestone produced by the taxpayer, and that the processes employed by the taxpayer to arrive at

its product were the ordinary treatment processes normally applied by mine owners to obtain such product. Such findings support the court's conclusion that the taxpayer is entitled to use as its depletion base the gross income from the sales of its pulverized chemical grade limestone except for the costs of blending of chemicals and bagging. The percentage depletion is also, of course, subject to the statutory limitation that it shall not exceed 50 per cent of the net income of the taxpayer.

The Commissioner makes an additional contention, covering two pages of his brief, that all costs of bagging and chemical additives were not excluded in determining the depletion base. The claim apparently is that, while costs of bags and chemicals were deducted, a proportionate share of labor costs, depreciation, operating expenses, and overhead should be allocable to these processes by reason of section 29.23(m)-1(f), Regulations 111. This question was raised in the Tax Court in connection with motion for reconsideration and the Rule 50 Computation. The Commissioner in his brief cited no authority in support of his additional contention, other than the regulations, and has failed to point out any fact supporting his contention that the Tax Court erroneously computed the depletion base. The burden is upon the Commissioner as petitioner to demonstrate that error has been committed. This he has failed to do.

Affirmed.

TAX COURT OF THE UNITED STATES

ALBIN C. HALQUIST AND MADELINE E. HALQUIST, PETITIONERS,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

[33 T.C. 304]

Docket Nos. 65794, 71133. Filed November 25, 1959.

DRENNEN, *Judge:* Respondent has determined deficiencies in petitioners' income tax in Docket No. 65794 for the years 1951, 1952, and 1953 in the amounts of $29,545.10, $32,134.08, and $17,974.86, respectively, and in Docket No. 71133 for the year 1954 in the amount of $24,957.92. By amended petition in Docket No. 65794, petitioners claimed overpayments of tax in 1951, 1952, and 1953 of $1,356.40, $56.94, and $4,609.30, respectively.

The issues for decision are: (1) In regard to the building and dimension stone produced and sold by petitioners, whether the gross income from the property for purposes of computing the percentage depletion allowance should be determined by reference to the sales price of the fully processed stone or by reference to the actual or representative market price of the stone in a less processed form; and (2) for years 1951, 1952, and 1953, whether petitioners are entitled under section 114(b)(4), I.R.C. 1939, to the 10 per cent depletion rate provided for dolomite or the 15 per cent rate provided for chemical or metallurgical grade limestone.

Findings of Fact.

Some of the facts have been stipulated and are incorporated herein by this reference.

Albin C. Halquist and Madeline E. Halquist, his wife, residing in the Town of Lisbon, Waukesha County, Wisconsin, throughout the years material hereto, were engaged in business as a partnership under the name of Halquist Lannon Stone Co. They filed joint and partnership income tax returns for each of said years on a calendar year accrual method of accounting with the district director of internal revenue at Milwaukee, Wisconsin. In addition, for each of the taxable years 1952 and 1954 they filed amended joint income tax returns, and for 1954, an amended partnership return.

Throughout the taxable years the partnership owned and operated two stone quarries in Waukesha County, Wisconsin. One of them, their principal quarry, was located approximately 2 miles south of the Village of Sussex in the Town of Lisbon, and their smaller quarry, in the Village of Sussex. (Reference will hereafter be made only to the principal quarry, our holdings concerning which will also include the smaller quarry and its production.)

The partnership engaged in the business of removing the stone, processing it, and selling it in the form of two principal products. These products were crushed and broken stone of various grades and sizes, and building or dimension stone in various shapes and sizes. In addition, the partnership produced and sold flagstone and drywall stone. The crushed and broken stone was sold for a variety of purposes, including riprap, ballast,

road surfacing, and agricultural lime. The dimension stone, sometimes referred to herein as building stone, consisted of blocks and slabs of natural stone cut in definite shapes and sizes to be used primarily for building purposes. The principal dimension stone product produced by petitioners was house-veneer stone. In the building stone category, however, they also occasionally produced "specials," sills, finished architectural stone, and other stone fabricated for special purposes according to specifications. Flagstone, generally used for landscaping purposes, is irregularly shaped stone approximately 2 inches thick and having at least one flat side. Drywall stone, usually 8 to 10 inches in width and from 2 to 4 inches in height, is generally used for laying up retaining walls without mortar joints.

The partnership also engaged in the purchase and resale of dimension stone produced by quarries in other parts of the United States.

Stone in petitioners' quarries is known as "Lannon stone" taking its name from the Lannon district which consists of an area approximately 12 miles square, and lies within the portion of the Niagara dolomite formation adjacent to Lake Michigan in Wisconsin. Although the physical and chemical characteristics of all of the stone within the formation are about the same, the formation of the stone in petitioners' quarry is found in two distinct phases. The uppermost strata consists of very thinly bedded slabs of dolomite which are broken by irregular vertical seams or joints so that pieces of stone occur naturally in blocks of a few square feet to perhaps 25 or 50 square feet in areal extent and 2 to 6 inches in thickness as a general rule. Since it

can be taken out in blocks, the stone from this portion of the quarry, extending down about 15 feet in depth, referred to herein as the upper face, is particularly adaptable for the production of dimension stone suitable for building purposes. Also found in this higher strata, at its very upper level, is a thinner layer of stone which is suitable for producing flagstone and drywall.

The lower face is exposed down to about 40 feet in the mine quarry and is characterized by horizontal bedding planes and vertical joints of a markedly different nature. It is more irregularly bedded and much more irregularly broken up by seams, and as a result, is suitable only for processing into crushed and broken stone and agricultural lime.

The horizontal layers of stone in the upper strata from which building stone was produced were extracted and processed in the following manner:

(1) Small holes were drilled vertically into the stone behind the upper face of the quarry, and a small quantity of black powder was inserted in these holes and detonated. The blast did not break up the rock, but the resulting gases followed the natural bed layers and seam faces and loosened the stone from the natural bed deposit. The slabs of stone, ranging from 2 to 3 square feet to extremes of 100 square feet in the horizontal plane (the smaller size pieces were more predominant in petitioners' quarry), were loosened one from the other with crowbars and wedges.

(2) At the upper face blockmen broke the larger pieces of stone into irregularly shaped pieces using one of two methods—either by a blow from a hammer after first scoring along the line on which it was to be broken,

or by plugging and feathering, which also involved scoring, then the drilling of holes on the scored line and, finally, the driving of wedges into the holes until the stone split.

(3) Using large steel pans the blockmen then sorted the pieces into three categoriees. Into one pan they placed waste; into the second pan, flagstone and drywall requiring no further processing; and into the third pan they placed the pieces of stone suitable for processing into dimension and building stone. At this point, at the upper face of the quarry, there was approximately one pan of waste for each pan of flagstone, drywall, and stone to be further processed into dimension stone, resulting then in a waste factor of 40 to 50 per cent. The waste pans were hauled to the edge formed by the bed of the upper face and the top of the lower face, and the waste was dropped to the bed of the lower face to be picked up by mechanical shovels and fed to the crusher. Neither flagstone nor drywall was cut or dressed by cutters, but was broken into desired sizes by blockmen at the face and then merely set aside. The pans containing the stone suitable for processing into dimension stone were carried by trucks operated by blockmen to the cutters, who were arranged around the edge of the quarry mentioned above at a distance of from 50 to 250 feet from the place where the stone was quarried. After large diamond saws were purchased in the latter part of 1954 and were used to perform a smaller part of the cutting operation, stone was also carried by the blockmen to the sawyers.

(4) The cutters then cut and broke the stone into smaller pieces having regular shapes and suitable for

use as dimension or building stone. The principal product produced by the cutters of petitioners' company was house-veneer stone, which was of random lengths and heights depending upon the size and shape of the stone taken out of the quarry. Its width, however, was uniformly a maximum of 4 inches.

(5) Production of the dimension stone by the cutters, which involved cutting, dressing, and drilling of the stone to desired dimensions, was accomplished primarily by the use of hand tools, which included hammers, tiflers, a variety of chisels, bullwedges, shims, and electric handsaws. To separate or break the stone the cutters utilized several methods. One involved the scoring of the stone with an electric handsaw or a type of chisel called the tracer and then the striking of the chisel with a hammer. A more common method was to score the stone and then continue to trace all along the line until the stone split—tracing consists of striking a stone with a hammer and chisel. The third method, known as bullwedging, used to break the thicker pieces of stone, involved scoring, and the chiseling of a small hole into which were placed shims and a wedge; striking of the wedge with a hammer caused the stone to split.

With the large saws, installed by petitioners in 1954, it was possible to saw much larger pieces of stone than had theretofore been handled by individual cutters. Whenever a slab was obtained from the face of the quarry which was large enough to allow economic use of the diamond saw the slab was not broken at the face of the quarry but was brought to the saw and sawed to dimensions suitable for building stone.

Of the stone brought from the quarry to the cutters

for further processing, another 40 to 50 per cent by weight was lost in processing to finished dimension stone; here again this waste was directed to the crushing processes.

The stone deposit below the building stone level of the quarry, which was wholly unfit for use in producing building stone, and the waste from the building stone processes were utilized by petitioners to produce crushed or broken stone and agricultural lime. Stone was secured from the quarry and processed into crushed stone in the following manner:

(1) Charges of dynamite were lodged into deep vertically drilled holes and detonated. Large quantities of stone were, as a result, hurled to the quarry's floor. Most of the stone freed from the quarry face was in pieces small enough to be directed to the crusher; the large pieces were broken by a steel ball. The stone thus blasted and broken from the face of the quarry was then lifted by mechanical shovels and hauled to the crusher which was located at the quarry.

(2) The primary crusher crushed the stone into sizes ranging from dust to over 3 inches in diameter. By conveyor belt the stone was automatically run through a screening process which segregated it into 7 sizes. Stone over 3 inches in diameter was automatically returned to the primary crusher for additional crushing. Some of the stone, 1 to 3 inches in diameter, was run through a hammermill for a secondary crushing operation if smaller sizes were needed, and this stone was also automatically screened and graded.

(3) In the latter part of 1952, petitioners purchased a new crushing plant. From that time on through the remainder of the years involved, the new larger primary crusher was utilized. Also, in addition to the primary crusher and a hammermill, the new plant had a gyratory crusher which was utilized instead of the hammermill for secondary crushing of some of the stone.

The other type of stone handled by petitioners was building stone that was purchased from various parts of the country, almost all of which was different in nature and character from the type of stone found in the Lannon area. Most of this stone was purchased in finished form and was handled by petitioners in order to complete their stone line and to meet consumer requests. Only a small portion was purchased in rough block form and cut by petitioners. Included in the stone purchased was a negligible number of rough blocks of Lannon stone from the very few quarries in the area whose deposits enabled them to take out solid pieces large enough to be processed by saw. This purchased stone facet of petitioners' business is not in issue here.

During the years 1951 through 1954, the selling price of drywall in this area was about $6 per ton; of flagstone, about $10 per ton; and of house-veneer stone, about $26 per ton. Sills and other specially finished architectural stone averaged about $50 to $70 per ton. Crushed stone was marketed by petitioners at prices ranging from approximately $1.03 to $1.23 per ton.

For each of the taxable years, total sales in tons and dollars (after reduction for delivery and trade dis-

counts, i.e., "gross income from the property"), direct costs, and net income (after allocating the selling and administrative expenses) attributable to crushed stone and building stone were as follows (cents omitted):

	1951		1952		1953		1954	
	Building stone	Crushed stone	Building stone	Crushed stone	Building stone	Crushed stone	Building stone	Crushed stone
Tonnage	18,814	69,097	18,891	83,387	17,249	176,689	12,311	155,537
Sales	$426,780	$84,781	$389,822	$102,278	$355,699	$182,229	$294,399	$179,616
Direct costs	$287,322	$64,533	$260,058	$108,481	$257,203	$124,731	$217,760	$151,851
Net income	$105,687	$8,299	$107,576	($9,840)	$72,787	$44,508	$55,079	$15,900

In computing the depletion deduction, petitioners used as the gross income from the property the gross proceeds less delivery costs and discounts from the sale of crushed and broken stone, flagstone and dry-wall, and fully processed dimension stone, and for the years 1951 through 1954, claimed $54,840.27, $46,294.99, $84,074.73, and $45,242.77, respectively. On the theory that gross income from the property in respect to the finished dimension stone must be limited to the value of rough uncut stone prior to cutting and finishing, respondent in his deficiency notice disallowed petitioners' depletion deductions to the extent of $42,357.73, $45,346.63, $14,854.55, and $41,094, respectively. By amended answer respondent subordinated to an alternative status the basis of his deficiency notice and placed primary reliance on his so-called "least-processing" theory with any increased deficiencies that may result to be redetermined by the Court.

Although numerous dolomite or limestone deposits occur throughout the country, only a relatively few

consist of rock that would satisfy the exacting requirements of dimension stone. Deposits with irregularly or closely spaced joints are unsuitable, as large blocks free from cracks or lines of weakness are demanded. Furthermore, only those deposits that are compact, easily workable, uniformly textured, and attractively colored merit consideration for such use. Among the dolomite or limestone deposits suitable for the extraction of stone usable for building purposes, there is a great deal of variation in the spacing and arrangement of the bedding planes, seams, and joints, and this in turn determines the size and shape of the blocks of stone which can be removed from a particular deposit. The nature of the stone deposit will also determine the processes which can be employed in its extraction and fabrication into building stone.

Bedford-Bloomington (Indiana) limestone, which is also used for building stone, occurs in large monolithic deposits running to depths of approximately 70 to 80 feet. The widely spaced joints in the stone permit its extraction in large, regularly shaped blocks. As a result the quarries in Indiana utilize channeling machines or wiresaws and produce rectangularly shaped blocks of uniform dimensions having relatively smooth faces. These rough blocks, relatively large and regularly shaped, rather than being processed and finished into dimension stone at the quarry are sold to cut-stone processors in the Chicago and Milwaukee market area.

The characteristics of the Niagara dolomite escarpment, as extensive as it is in Wisconsin, apparently make possible the extraction of only a limited amount

of stone suitable for processing into dimension or building stone. Building stone quarrying in the escarpment is largely confined to the Lannon district and a small area south of Fond du Lac, Wisconsin. And there the relatively thin horizontal bedding planes and irregular vertical seams or joints result in the production of blocks considerably smaller, more irregular, and rougher than blocks quarried in Indiana. The horizontal beds of the upper strata (the source of the building stone) of petitioners' quarry generally occurred in thicknesses of only 2 to 6 inches—only once did petitioners uncover a layer which reached 30 inches in depth. The small and irregular blocks of Lannon stone were not suitable for processing into building stone by mechanical means and were necessarily processed from the initial stages through the finished stone largely by hand.

Cut-stone processors, who cut building stone which is competitive with petitioners' finished building stone, find it uneconomical and unfeasible to purchase for processing the rough slabs or blocks of Lannon stone quarried by petitioners. From Indiana and other areas of the country the commercial processors can procure a steady and dependable supply of very large blocks of uniform shape and dimension that can be economically processed by large-scale machine operations. The character of Lannon stone generally precludes the production of blocks of this type or volume. Whereas the processing of uniformly shaped blocks of Indiana limestone involves only about 5 per cent waste, processors would be required to transport from the Lannon district quarries up to 50 per cent waste.

and then be faced with a difficult disposal problem at their processing plants. Moreover, Lannon stone is more difficult to fabricate after its natural moisture has dried out, and, therefore, has to be cut very shortly after it has been quarried; also, this stone is not readily workable on the large bedded planers, one of the more important of the processors' machines. On both counts the converse is true in the case of Indiana limestone.

As a result, there was no market among processors, or anyone else, for petitioners' rough uncut blocks of stone. It was necessary for almost all of the quarries in the Lannon area to process their own stone into finished building stone at the quarry and to sell directly to the ultimate user in order to compete with Indiana limestone.

Petitioners were one of approximately 40 operators producing building or dimension stone in the Lannon and Fond du Lac areas. Many of the quarries were operated by 1 or 2 men and the average quarry employed about 5 men. Petitioners with approximately 70 or 80 men produced 50 per cent of the building stone quarried in the Lannon district. The processes they utilized from the initial stages of quarrying through the cutting and shaping of the finished stone were similar to those used by the other building stone operators in the Niagara dolomite formation.

The first commercially marketable mineral products produced by petitioners during the years 1951 through 1954 were crushed and broken stone, flagstone and drywall, and finished dimension stone after completion of the necessary cutting, breaking, and trimming

processes, all of which were ordinary treatment processes normally applied by mine owners to obtain the commercially marketable mineral product from their raw mineral deposit.

A chemical analysis of the stone in petitioners' quarry revealed a composition averaging in content 51.72 per cent calcium carbonate, 45 per cent magnesium carbonate, and 3.28 per cent total impurities, including a silica content of 2.85 per cent. This stone found in petitioners' quarry was dolomite.

OPINION

There is no dispute that under section 114(b)(4), I.R.C. 1939,[1] and section 613(a), I.R.C. 1954,[2] petition-

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[1] SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(b) BASIS FOR DEPLETION.—

* * * * *

(4) PERCENTAGE DEPLETION FOR COAL AND METAL MINES AND FOR CERTAIN OTHER MINES AND NATURAL MINERAL DEPOSITS.—

(A) In General.—The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

* * * * *

(ii) in the case of * * * dolomite * * * 10 per centum,

(iii) in the case of * * * metallurgical grade limestone, chemical grade limestone * * * 15 per centum, * * *

* * * * *

of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed

[Footnote 2 on Page 57]

ers are entitled to a percentage depletion allowance on the stone that they quarried. This allowance is based on a specified percentage, depending upon the specific mineral mined, of the gross income derived from the property to the extent that it does not exceed 50 per cent of the net income ("taxable income" in I.R.C. 1954) from the property. "Gross income from the property" is defined in section 114(b)(4)(B), I.R.C. 1939, and section 613(c), I.R.C. 1954, as the gross income from mining, and "mining" is to include, in addition to the extraction of the ore or mineral from the ground, the "ordinary treatment processes normally applied by mine owners and operators in order to obtain the commercially marketable mineral product or products."

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50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

(B) Definition of Gross Income From Property.—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *

[2] SEC. 613. PERCENTAGE DEPLETION.

(a) GENERAL RULE.—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per cent of the taxpayer's taxable income from the property (computed without allowance

With the objective of providing a simplified method of computing depletion allowances which would avoid the complications and difficulties arising in connection with cost and discovery depletion, Congress in 1926 introduced percentage depletion based on "gross income from the property."[3] The ambiguity inherent in the phrase "gross income from the property" and the dis-

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for depletion). In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

(b) PERCENTAGE DEPLETION RATES.—The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

* * * * *

(6) 15 percent—all other minerals (including, but not limited to * * * dolomite, * * * limestone * * * stone (used or sold for use by the mine owner or operator as dimension stone or ornamental stone), * * * except that * * * the percentage shall be 5 percent for any such other mineral when used, or sold for use, by the mine owner or operator as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. * * *

* * * * *

(c) DEFINITION OF GROSS INCOME FROM PROPERTY.—For purposes of this section—

(1) GROSS INCOME FROM THE PROPERTY.—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) MINING.—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *

[3] Sec. 204(c)(2), Rev. Act 1926, 44 Stat. 16; Report of Committee on Finance, S. Rept. No. 52, 69th Cong., 1st Sess., p. 17.

putes arising therefrom led to the enactment[4] in 1943 of the definition found in subsection (B) of section 114(b)(4), which has been carried substantially intact through the 1954 Code. Although it then became clear that the gross income upon which the depletion allowance was to be based was to include income derived from processes that went beyond mere extraction of the mineral from the ground, the basis for disputes had not been eliminated—it shifted in focus to the interpretation of the new phrase "ordinary treatment processes normally applied by mine owners and operators in order to obtain the commercially marketable mineral product or products."

It was soon settled that "commercially marketable mineral product" meant the *first* commercially marketable mineral product resulting from the application of ordinary treatment processes. *International Talc Co.*, 15 T.C. 981; *Black Mountain Corporation*, 21 T.C. 746; *Riverton Lime & Stone Co.*, 28 T.C. 446.

In an effort to limit the scope of "mining" as defined in subsection (B), however, the Commissioner persistently attempted to distinguish and draw a line between extraction processes and manufacturing processes, arguing that the latter were not allowable "ordinary treatment processes." The courts rejected this effort. In *United States* v. *Cherokee Brick & Tile Company*, 218 F. 2d 424 (C.A. 5); *United States* v. *Merry Brothers Brick and Tile Co.*, 242 F. 2d 708 (C.A. 5), certiorari denied, 355 U.S. 824; and *United States* v. *Sapulpa*

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[4] Sec. 124(c), Rev. Act 1943, 58 Stat. 45; Report of Committee on Finance, S. Rept. No. 627, 78th Cong., 1st Sess., p. 23.

Brick and Tile Corporation, 239 F. 2d 694 (C.A. 10), contrary to the Commissioner's contention that the processes by which raw clay was transformed into burnt brick and tile were unallowable manufacturing processes, it was held that fully processed brick and tile were the first commercially marketable products from the mineral involved, and that all of the processes utilized to obtain this product were ordinary treatment processes. *Dragon Cement Company* v. *United States,* 244 F. 2d 513 (C.A. 1), certiorari denied 355 U.S. 833, held that manufactured cement, involving a chemical change in the processing of the raw mineral, was the first commercially marketable product from cement rock. *Riverton Lime & Stone Co., supra,* held that hydrated hydraulic lime was the first such product from a limestone mine. In *Townsend* v. *Hitchcock Corporation,* 232 F. 2d 444 (C.A. 4), pulverized talc and talc crayon were found to be the commercially marketable products obtained from ordinary treatment processes, regardless of whether they may be considered to be "manufactured" products. These and other courts were of the uniform opinion that the statutory language was clear and unambiguous, and that gross income from mining included the income from all processes ordinarily and normally applied to obtain the first product marketable in commerce. The depletion allowance not being an allowance upon any processes as such, did not necessitate distinguishing between mining processes and manufacturing processes.[5]

[5] Following denial by the Supreme Court of certiorari in *United States* v. *Merry Brothers Brick and Tile Co.,* 242 F. 2d 708 (C.A. 5), certiorari denied 355 U.S. 824; and *Dragon Cement Company*

Shifting his emphasis now to a new theory which would restrict the scope of the depletion allowance, respondent here argues that the first commercially marketable mineral product in any particular mining industry is the crudest, least processed product for which a commercial market exists in the United States in more than negligible quantities, and that the processes utilized and normally applied by mine owners and operators in that industry to produce this crudest marketable product are the only processes which can be considered to be ordinary treatment processes within the meaning of the statute. To ascertain the crudest, least processed, yet marketable, product for the particular mineral industry involved, respondent would look to the country as a whole. Once the product base had been determined for an entire industry it would serve as the standard for all of the producers of that mineral, notwithstanding that an individual miner or operator may not produce or market it or be capable of marketing it at a profit. Those who processed and marketed a product other than the standard industry product would be required to utilize as their depletion base a gross income reconstructed by reference to the representative market price of the crudest, least processed marketable product from a mineral of like kind and grade, or if there is no such market price, respondent would allocate and eliminate on the basis of costs all income attributable to processes beyond those necessary to produce the crudest product.

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v. *United States*, 244 F. 2d 513 (C.A. 1), certiorari denied 355 U.S. 833, Internal Revenue Service announced that the decisions in the "brick and tile" cases would be accepted and followed. T.I.R. 62, Oct. 18, 1957.

For the dolomite and limestone industry, then, respondent shows that the crudest, least processed product marketed in more than negligible quantities is crushed and broken stone. The processes normally applied by limestone and dolomite operators to obtain crushed and broken stone, respondent contends, are the only "ordinary treatment processes" contemplated by the statute. This would be so in spite of the variety of products which may be and are in fact produced from a limestone or dolomite mine. Thus in petitioner's case the gross income from the sales of their crushed stone would all be includible in the depletion base. On the other hand, respondent insists, income from the sale of building or dimension stone, a more highly refined product utilizing processes quite different from those required to produce crushed stone, would be excluded to the extent of the income attributable to the additional processing steps—that is, income from the sale of building stone must be limited to the income that would have been derived if such stone had been sold as crushed and broken stone.

The so-called "least-processing" theory appears to have first been advanced by respondent before the Seventh and Eighth Circuits in his appeals from the District Court's decision in *Cannelton Sewer Pipe Co.* v. *United States*, 268 F. 2d 334 (C.A. 7), and from this Court's decision in *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398 (C.A. 8), affirming 28 T.C. 881, both of which were still pending when the case here before this Court was submitted. Since then both appellate tribunals have handed down their decisions and both totally rejected respondent's interpretation.

In *Cannelton*, the taxpayer mined fire clay and shale and manufactured therefrom vitrified clay sewer pipe and related products. The income derived from the sale of his fully processed products was used as his basis for depletion. The Government urged that since there was an existing substantial market for raw clay and shale in the immediate area, as well as in the State of taxpayer's mine, the raw unprocessed mineral was his first commercially marketable product. The court pointed out that taxpayer's mining costs alone, due to a more expensive underground type of operation, exceeded the current selling price of raw clay and shale, and in view of this fact was unable to understand how raw clay and shale could be considered commercially marketable products for this particular taxpayer. In the Court's view, taxpayer had to be in a position to sell his product at a profit before it was "commercially marketable," and in order to achieve this end, taxpayer found it necessary to further process his raw material into vitrified clay sewer pipe. The evidence also showed that integrated mining and manufacturing operations wherein the raw material was processed by the mining operators into a finished product was the rule rather than the exception in taxpayer's area in the year involved, and that the treatment processes used to obtain his finished products were ordinary and normal. In rejecting respondent's contention that there can be only one depletable or commercially marketable product for each mineral, the court said:

> The short answer to this is that we do not agree that it was intended that the depletion allowance for each mineral be reduced to the common de-

nominator represented by a conceivable product most cheaply produced from each mineral.

Again respondent urged in *Iowa Limestone* that the crudest, least processed product marketable from taxpayer's limestone quarry was crushed limestone, even though taxpayer marketed only finely ground or pulverized chemical grade limestone. Although there clearly was a market for crushed limestone for road and agricultural purposes and taxpayer's stone could have all been crushed and utilized for such purposes (as a minor amount of dirty and contaminated material was), his deposit of limestone was a relatively rare and special type particularly suitable for chemical use. In its pulverized form processed for chemical use, the limestone was considerably more valuable and commanded a higher price than crushed stone. The court was of the opinion that the taxpayer—

> had the right to market its chemical grade limestone for the purpose for which it was most suited and in a field where it would command a fair price. Gold, silver, and iron ores and other valuable minerals could doubtless be sold for road rock, fill, or ballast, but no one would contend that their value must be determined upon such a limited use of such products. It was not economically feasible for the taxpayer to market its superior stone as ordinary road rock. Many kinds of cheap stone would equally serve such a purpose.

While there are some differences in the facts in those two cases and in this case, the courts in those

cases specifically rejected substantially every argument advanced by respondent in this case in support of his most recent theory, and we think the principles announced in those decisions are equally applicable here.

In both of those cases the courts rejected the argument that the one most cheaply produced product of the mineral that could be produced and sold at a profit by someone somewhere in the country was the commercially marketable product for all taxpayers in that industry, regardless of whether it was economically feasible for the particular taxpayer to produce and market that product at a profit. Both courts stated that the profit-making aspect must be given consideration in determining whether a mineral product is commercially marketable, and that the taxpayer has a right under the statute to market its mineral for the purpose for which it is most suited. We agree. *Riverton Lime & Stone Co., supra; Iowa Limestone Co.*, 28 T.C. 881.

In *Iowa Limestone*, the Court of Appeals also rejected respondent's argument that for depletion purposes all types of limestone must be considered the same mineral. We agree that the depletion base of a taxpayer is not limited to the gross income that would be produced by the sale of the most inferior grade of the mineral produced by him, but is the gross income that would be produced by the sale of the first commercially marketable products of the mineral produced for the purposes for which it, in its natural state, is best suited. Here the finished building stone was not merely the product of extended crushed stone processing, but originated in the raw material itself, so formed

as to be peculiarly adaptable to building purposes, and the processing took an entirely different course from the beginning. This case is, therefore, distinguishable from *Black Mountain Corporation, supra,* where the Court disallowed income attributable to oil treatment of coal, and *Sparta Ceramic Company* v. *United States,* 168 F. Supp. 401 (N.D. Ohio), wherein the court disallowed the glazing of tile, because in those cases the processes disallowed were additional processing of already marketable products to produce a more expensive product.

We find no inequity in allowing a taxpayer who has a high-grade mineral a greater depletion base than one who has a lower grade of the same mineral. Depletion is designed to permit a taxpayer to recover the value of his wasting asset mined and removed. *Anderson* v. *Helvering,* 310 U.S. 404; *Dragon Cement Company* v. *United States, supra.* Petitioners here, with a dolomite suitable in part for building stone, have a greater value to recover than would a person who owned a quarry with dolomite suitable only for crushed stone purposes. For respondent to say that there is no more exhaustion of the mineral deposit through the extraction of a ton of stone suitable for building purposes and a ton of stone which may be used only in crushed form is to ignore the difference in economic value between each ton.

We believe Congress recognized that the value of natural resources might fluctuate widely, depending upon their accessibility or the products which they are capable of yielding, by making the gross income from the property serve as the base for computation. Respond-

ent would deny this result by his "least-processing, single product" theory. If Congress, in its quest for simplicity, had intended the result prescribed by respondent it could have more simply specified the single product which was to form the basis for depletion for any particular mineral industry. It is no answer to say that differences in the value of natural resources are taken care of in the rate of depletion. Respondent claims that all dolomites should be allowed the same rate of depletion, so under his theory there would be no recognition at all of differences in value of various types or grades of dolomite.

One distinction in the facts in this case and the *Cannelton* and *Iowa Limestone* cases which respondent emphasizes is the fact that petitioners here actually produced crushed stone in their larger quarry and could in all likelihood have crushed the building stone and marketed it at a profit in that form, whereas in *Cannelton,* petitioner could not have marketed raw fire clay at a profit, and in *Iowa Limestone,* petitioner did not actually market its limestone as crushed stone, although it could have been so marketed. But both cases established that the depletion allowance for a mineral need not be limited by a product most cheaply produced from the mineral and that a taxpayer has the right to market his mineral for the purpose for which it is most suited. And that the depletion base for a taxpayer may consist of income from the sales of more that one product has been uniformly recognized by other courts. *United States* v. *Cherokee Brick & Tile Company, supra; United States* v. *Sapulpa Brick and Tile Corporation, supra; United*

States v. *Merry Brothers Brick and Tile Co., supra*; *Townsend* v. *Hitchcock Corporation, supra*; *Richland Shale Products Company* v. *United States*, 168 F. Supp. 731 (E.D. S.C.); *Arvonia-Buckingham Slate Company* v. *United States*, 167 F. Supp. 903 (E.D. Va.); *Carnelton Sewer Pipe Co.* v. *United States, supra*. To rely on the factual distinction above mentioned would suggest the absurd result that petitioners would be entitled to less depletion on their building stone in their main quarry where the crusher was located than on their building stone in their smaller quarry where there was no crusher; and less than other smaller building stone producers in the area are entitled to on their building stone of like quality just because they had no crusher.

Respondent argues in the alternative that if crushed stone is not the first commercially marketable product for all of petitioners' stone, then rough uncut stone is the first marketable product for their building stone, and that either the selling price of their drywall stone, or a representative price of rough uncut blocks of dolomite and limestone suitable for processing into finished building stone should be used as their basis for depletion.

It is clear from the evidence that it would be economically unfeasible, and probably impossible as well without a great deal of waste, for petitioners to attempt to cut their dimension stone into either flagstone or drywall. Petitioners sell all of their stone that is suitable for this purpose as flagstone or drywall because it requires no processing. Because it requires no processing, it can be sold for less than it costs petitioners

to process even their building stone. While flagstone and drywall may be the cheapest to produce and first commercially marketable product of petitioners' quarry, that does not make it the first commercially marketable product of that part of petitioners' mineral deposit suitable for building stone.

The evidence also indicates that there is virtually no market for uncut Lannon building stone, principally because only about 25 per cent of it can be made into usable building stone, and it would cost a stone processor too much to transport and store the waste. The market for rough stone was created by stone of an entirely different type, principally Indiana limestone, which is capable of being quarried in large blocks of uniform dimensions and can be processed into building stone with relatively little waste and after a considerable lapse of time. We feel that petitioners have established that the rough uncut blocks of their Lannon stone were not commercially marketable until cut or sawed into finished dimension or building stone. If we were to hold otherwise we see no reason why the price of rough uncut stone should not be applied to the entire tonnage of the uncut building stone produced by petitioners at the time it is first separated from its natural deposit and before any of it is broken into waste, and we feel this would produce an unrealistic and uncontemplated result.

Application of respondent's crudest, least-processed theory uniformly throughout the building stone industry would require use by most of the producers in the Milwaukee area of entirely hypothetical gross income and net income figures to establish their depletion al-

lowances. The statute refers to the "gross income from the property" and the "net income of the taxpayer * * * from the property." Sec. 114(b)(4)(A), I.R.C. 1939. We do not think this calls for use of hypothetical income figures when the income of the taxpayer from his property is ascertainable from his own receipts and expenditures.

We hold for petitioners on this issue. By doing so, however, we do not intend to imply that a producer of building stone may include in gross income from the property for depletion purposes the entire sales price of his finished stone regardless of the amount of processing used to produce it. The selling price of the stone processed to the point that it is commercially marketable for the purpose for which it is best suited should be the basis for depletion. We do not have sufficient evidence before us in this record to determine whether the apparently negligible amount of ornamental stone, or "specials," sold by petitioners were the first commercially marketable products within the meaning of the statute or were refinements of a commercially marketable product, and we are not deciding that here. The parties have stipulated the figures to be used as gross income if we sustain petitioners' position that they are entitled to compute depletion on the basis of their gross income from sale of crushed stone, after all crushing operations, plus sales of building stone after all cutting processes have been performed. Inasmuch as we have found that the basis for computing percentage depletion used by respondent in his notice of deficiency, being a hypothetical selling price of rough uncut stone, is not correct, the presumptive

correctness of respondent's determination has been overcome and the only evidence we have before us favors petitioners' method of computing their gross and net income for depletion purposes.

The remaining issue concerns the proper percentage depletion rate to be applied to petitioners' product for the years 1951 through 1953 under the Internal Revenue Code of 1939. As a result of revisions in the 1954 Code and a more explicit delineation of the mineral categories applicable to petitioners' products, the parties are in agreement as to the rates to be applied for the year 1954. In respect to the earlier 3 years, respondent determined that the rock quarried by petitioners was limited to the 10 per cent rate provided for dolomite. Petitioners agree that the rock was dolomite, but argue that it also qualified as "metallurgical grade limestone, chemical grade limestone" [6] and is entitled to the higher 15 per cent rate provided for in the statute.

The essential constituent of limestone rock is calcium carbonate. When the rock also contains in addition magnesium carbonate to the extent of 35 or 45 per cent of its composition, it is known as dolomite. *Virginian Limestone Corporation*, 26 T.C. 553; *Blue Ridge Stone Corporation* v. *United States*, 170 F. Supp. 569 (W.D. Va.). There is little question that the rock quarried by petitioners, with a magnesium carbonate content of 45 per cent, was dolomite and is clearly entitled to at least the 10 per cent rate specifically provided for by section 114(b)(4)(A)(ii). The question

[6] For convenience, hereafter referred to as "metallurgical or chemical grade limestone."

of first impression before us, however, is whether dolomite can at the same time be a "metallurgical" or "chemical grade limestone" under the statute, and if so, whether Congress intended the 10 per cent or 15 per cent rate to apply to a dolomite so qualifying.

The legislative history of the Act by which this mineral was added to the depletion statute in 1951 gives only general guidance as to what was intended by Congress. The Report of the Senate Committee on Finance on the Revenue Act of 1951 (S. Rept. No. 781, 82d Cong., 1st Sess., p. 38) stated: "The names of all the various enumerated materials are of course intended to have their commonly understood commercial meaning." The conference report on this Act (H. Rept. No. 1179, 82d Cong., 1st Sess., p. 75) contained the following language:

> It is intended, in any case where a mineral is specifically provided for at a stated rate of percentage allowance, that the specific provision will govern the allowance provided (whether higher or lower) for a more general classification.

However, the legislative history gives no clue as to what was intended to be included in the terms "chemical grade" and "metallurgical grade" limestone. *Wagner Quarries Company* v. *United States*, 154 F. Supp. 655, affirmed per curiam 260 F. 2d 907 (C.A. 6).

There apparently is no generally accepted and commonly understood commercial meaning of metallurgical or chemical grade limestone. The quality or composition of limestone required by the various industries utilizing it for its metallurgical or chemical properties

varies considerably with the industries or the use to which it would be put. While petitioners' expert witness in this case testified that he thought the term "limestone" is often used to include dolomite and that a dolomite having a combined magnesium and calcium carbonate content of 95 per cent could qualify as a chemical or metallurgical grade limestone, he also stated that a customer ordering chemical or metallurgical grade limestone would usually specify the minimum content of either magnesium or calcium carbonate and the maximum impurities acceptable. On the other hand, respondent's expert witness testified that a mineral or stone having the above composition would not be commonly understood to be chemical or metallurgical grade limestone.

We do not believe it is within our province to assume that Congress intended to include a high-grade dolomite within the classification chemical or metallurgical grade limestone when it specifically granted a 10 per cent rate to dolomite. This would be true even if we accept petitioners' contention that the term "limestone" is commonly understood to include dolomite and that dolomite with a combined carbonate content of 95 per cent would qualify as a chemical or metallurgical grade limestone. Absent some evidence that Congress intended the latter phraseology to encompass high-grade dolomite and thus overlap the term "dolomite" specifically used in the 10 per cent category, we will apply the concept stated in the conference report quoted above that when a 10 per cent rate was specifically provided for dolomite, that rate shall apply to all dolomite, whether it could also be classified as stone entitled

to a 5 per cent rate, as argued by respondent in *Virginian Limestone Corporation, supra,* or as chemical or metallurgical grade limestone entitled to a 15 per cent rate, as argued by petitioners here.

The more recent cases which have considered this particular question are not controlling because they did not involve a mineral which qualified as a specifically mentioned mineral as well as a chemical or metallurgical grade limestone. In *Iowa Limestone Co., supra,* it was held that a limestone which is at least 95 per cent pure, free from toxic impurities and containing not more than 1 per cent moisture, is known in industry and commerce as chemical grade limestone; but there the mineral contained at least 95 per cent calcium carbonate and hence was not dolomite. In *United States* v. *Wagner Quarries Company,* 260 F. 2d 907 (C. A. 6), the Court of Appeals said that "a reasonable interpretation of congressional intent in using the words 'metallurgical grade limestone, chemical grade limestone,' would mean limestone of high carbonate content with a very low silica or impurities percentage, capable of use for metallurgical or chemical purposes." But the mineral there involved was about 85 per cent calcium carbonate and 10 per cent magnesium carbonate, and thus was not dolomite.

On the other hand, this Court held in *Virginian Limestone Corporation, supra,* that if the mineral qualified as dolomite, it was entitled to the 10 per cent rate even though it might also be considered "stone," "calcium carbonates," or "magnesium carbonates" because the term "dolomite" is a term of specific designation, while the others are terms of general classification. We

recognize that the terms "chemical" and "metallurgical grade limestone" are not as general a classification as "stone." Nevertheless, petitioners' stone is dolomite and we do not think Congress intended that such a specifically designated mineral should be allowed a 15 per cent rate because it might also qualify as a chemical or metallurgical grade limestone any more than it should be limited to a 5 per cent rate because it also qualifies as stone. We stated in the *Virginian Limestone* case that the "provisions of the statute here involved are specific and free from ambiguity. In such situation, there is no room for an interpretation, by the Commissioner or by the Courts, which would vary (either upward or downward) the stated rates for specifically identified minerals, which Congress has provided." We reaffirmed that finding and that rule of statutory construction in *Spencer Quarries, Inc.*, 27 T.C. 392, dealing with quartzite. We believe they are equally applicable here.

The 10 per cent depletion rate allowed in the case of dolomite is applicable to all of petitioners' production here involved during the years 1951, 1952, and 1953.

Decisions will be entered under Rule 50.

Part C: Legislative Materials

Joint Committee Report, 1930

(Report to the Joint Committee on Internal Revenue Taxation From Its Staff, *Preliminary Report on Depletion*, vol. I, pt. 8 (1930))[1]

[12] METHODS PROPOSED FOR CONSIDERATION.

Inasmuch as the present system of depletion has been shown to be neither simple in its application nor equitable in its results, it is desirable to find a substitute for this system. Several methods have been proposed and considered, each one of which will be discussed.

(a) *Fixed rate per unit method.*—The first method proposed for consideration is the fixed rate per unit method. This method, as its name implies, consists of the allowance of a fixed amount per pound for the mineral sold. For example, assume that copper is worth 2 cents a pound in the ground, lead 1 cent a pound, coal 3 cents per ton, gravel 1 cent per ton—if a company sold 1,000,000 pounds of lead in the taxable year, its depletion allowance would be 1,000,000 pounds times 1 cent, or $10,000. While this method has never been adopted in the United States, it nevertheless is applied by Canada in determining the depletion allowance for coal.

One of the chief objections to the fixed rate per unit method is the great changes that would follow from its

[1] This report was originally published in 1929 and was then reprinted in 1930. Since the Government in its Appendix B (pp. 66-87), uses the 1930 pagination, we have also used such pagination in order to avoid confusion.

application. The following table shows the various units of depletion per pound at present allowed in the case of copper:

[13]

$0.0232	$0.0050	$0.0027	$0.0211	$0.0465	$0.0243
.0138	.0099	.0171	.0233	.0411	.0129
.0279	.0040	.0221	.0058	.0197	.0320
.0215	.0244	.0151	.0291	.0331	.0119
.0195	.0199	.0132	.0264	.0310	.0122
.0206	.0042	.0138	.0179	.0162	.0367
.03	.0081	.0360	.0189	.0217	.0080
.0148	.0289	.0373	.0206	.0407	
.0047	.0141	.0776	.0265	.0551	
.0191	.0193	.0843	.0108	.0272	

The mathematical average of the above depletion units is 0.0259. The highest depletion unit in the list is 0.0843 and the lowest is 0.0027. It is evident from the wide range in depletion units allowed under the present system that the new method would make a very great change in the depletion allowance in many cases if fixed depletion unit per pound is adopted. Furthermore, a depletion unit of 2½ cents per pound will in many instances completely wipe out the tax. To offset this, an arbitrary limitation would have to be imposed. Another difficulty in the method is the distribution of the depletion allowance between the lessor and the lessee in the case of leaseholds. A third criticism might be advanced on the ground that the allowance for depletion would bear no relation to the value of the ore, as a rich and valuable deposit would receive no greater depletion allowance than a low-grade deposit of practically no value.

* * * * *

Revenue Act of 1943: Presidential Veto Message, 1944

(90 CONG. REC. 1958, 1959 (1944))

[1958] TO THE HOUSE OF REPRESENTATIVES

I return herewith, without my approval, H. R. 3687, entitled "An Act to Provide Revenue, and for Other Purposes".

I regret that I find it necessary in the midst of this great war to be compelled to do this in what I regard as the public interest.

* * * * * *

[1959] The bill is replete with provisions which not only afford indefensible special privileges to favored groups but sets dangerous precedents for the future. This tendency toward the embodiment of special privileges in our legislation is in itself sufficiently dangerous to counter-balance the loss of a very inadequate sum in additional revenues.

Among these special privileges are:

* * * * *

(b) Percentage depletion allowances, questionable in any case, are now extended to such minerals as vermiculite, potash, feldspar, mica, talc, lepidolite, barite and spodumene. In the case of some of these minerals the War Production Board refused to certify that current output was inadequate for war needs.

* * * * *

In the interest of strengthening the home front, in the interest of speeding the day of victory, I urge the earliest possible action.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE, *February 22, 1944.*

House Hearings, 1947

(*Hearings Before the House Committee on Ways and Means on H.R. 1993*, 80th Cong., 1st Sess. (1947))[2]

[41]

House of Representatives
Select Committee on Newsprint
and Paper Supply
Washington, D. C.
June 12, 1947

Hon. BERTRAND W. GEARHART,
New House Office Building

MY DEAR COLLEAGUE:

* * * * *

Thenardite, a nonmetallic mineral commonly known as sodium sulphate, is absolutely essential in the manufacture and production of newsprint and kraft paper . . . .

* * * * *

Briefly, the situation now facing the newsprint and paper manufacturers is this: Without an adequate supply of this mineral, many paper mills will be com-

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[2] The Government in its Appendix B (pp. 231-34) quotes from these Hearings but omits the portion set forth below.

pelled to discontinue operations. Much of the newsprint paper has been imported from Canada. There has been an expanding development in this country in the manufacture of paper in the Southern States, utilizing cut-over timberlands which replenish themselves with new growth suitable for this purpose every 10 years. The Government has encouraged this development as a measure to conserve the timber suitable for lumber, which requires over 20 years' growth. Commendable advances have been made in this reforestation and conservation endeavor. We find paper mills utilizing this cut-over timber in Florida, Georgia, Alabama, Mississippi, Louisiana, and Texas and they require many thousands of tons of sodium sulphate. Otherwise, the material produced would be too tough for commercial use.

This committee is convinced that if newsprint and paper is to continue to be available for supplying the steadily increasing demand by the people of our Nation, some incentive must be furnished to encourage exploration and production of sodium sulphate. We believe that incentive can best be furnished by tax relief and that a percentage depletion allowance would furnish the most effective stimulus. The producer must be permitted to foresee a return of his capital, plus a reasonable profit in order to encourage mining investments.

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[42] CLARENCE J. BROWN,
Chairman, Select Committee on
Newsprint and Paper Supply.

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House Hearings, 1947

(*Hearings Before the House Committee on Ways and Means on Revenue Revisions, 1947-48,* 80th Cong., 1st Sess., pt. 5 (1947))

[3281] Statement of L. H. PARKER on Behalf of the Special Committee on Taxation, National Coal Association, Washington, D. C.[3]

Mr. PARKER. * * *

[3282] Thank you, Mr. Chairman, and I file this statement for the record.

Mr. WOODRUFF. That will be included as a part of your remarks, Mr. Parker.

(The statement referred to is as follows:)

TECHNICAL AMENDMENTS TO THE INTERNAL REVENUE CODE SUGGESTED BY THE SPECIAL COMMITTEE ON TAXATION, NATIONAL COAL ASSOCIATION, WASHINGTON, D. C.

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[3283] When the percentage depletion provisions applying to coal and metal mining were first made a part of the revenue statutes in the Revenue Act of 1932 and reaffirmed in the Revenue Act of 1934, the definitions of "Gross income from the property" and "Net income from the property", upon which the allowable computations of percentage depletion are based, were left by Congress for inclusion in the

[3] The Government in its Appendix B (p. 245) quotes a portion of the following statement submitted by Mr. Parker, but omits the portion set forth below.

regulations by the Commissioner of Internal Revenue.

The mine operators protested the definitions drafted by the Commissioner for inclusion in the regulations on the grounds that they did not express the clear intent of Congress. As a result, a group of mine operators and their representatives met with the officials of the Treasury late in December 1932 to discuss the matter. In this conference, it was agreed the definitions drafted by the Commissioner did not express the intent of Congress. However, as the regulations containing the definitions drafted by the Commissioner had, in the interim, been printed in bound form and been delivered to the Treasury Department and were ready for issuance, the Treasury representatives expressed reluctance to withdraw said regulations on the ground such a change could not be made and have the regulations issued in time for use in connection with the returns due to be filed March 15, 1933. To meet this situation, it was proposed that the regulations be issued as printed with the understanding the definitions would be interpreted and applied according to the meaning of the act as agreed to in that conference. The operators agreed to this procedure. The regulations were thus issued and the definitions were applied as agreed to up to about the latter part of 1938.

Beginning in about 1938 and progressively over subsequent years, the Commissioner of Internal Revenue made various changes in the interpretation and application of these definitions contained in the regulations, all detrimental to the mining operator entitled to an allowance as depletion. Some of these changes were covered by rulings issued by the Commissioner. How-

ever, in the main, the Commissioner merely took the position that his prior allowances had been contrary to the expressed wording of the regulations and the changes being made were for the purpose of complying with them.

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House Hearings, 1950

(*Hearings Before the House Committee on Ways and Means on Revenue Revision of 1950*, 81st Cong., 2d Sess., vol. I (1950))[4]

[470] Statement of Hon. HARRY P. O'NEILL, a Representative in Congress from the State of Pennsylvania.

House of Representatives,
Washington, D. C., February 14, 1950.

Mr. Charles W. Davis,
Clerk, House Ways and Means Committee,
House of Representatives, Washington, D. C.

DEAR SIR: I respectfully desire to make known to your committee my very deep concern in the matter of proposals under consideration for the reduction in depletion allowance, and their significance to the anthracite coal industry.

This underground mineral is found, in its marketable condition, only by the most expensive, hazardous, and speculative methods of search and exploration. This cost is met by private capital, and so the speculator expects, as he finds a profitable seam of coal, to be

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[4] The Government in its Appendix B (pp. 249-64) quotes from these Hearings but omits the portion set forth below.

permitted to, at least, repay himself for the gamble, as quickly as possible. The only method is by depletion allowance, as no public grant is available to the discoverer for his time, trouble, and money.

The only known acceptable method of keeping a successful explorer in his line of business, looking for more marketable veins, is the inducement of depletion allowance. He must be reimbursed and see a profit opportunity, or he will leave the search to another. The other will have to be public funds.

Who is there to sink a shaft deep into the earth to look for a merchantable mineral, a shaft safe enough to comply with State and Federal mine safety laws, that does not expect every opportunity to get even, and show a profit? If the seam is not found the entire venture is a total loss. This happens continually, and is as much a part of the industry as the fact that coal burns.

That coal is a required commodity, and particularly for war use, is not deniable. Examination of the bills of lading of any colliery will convincingly prove that the consignee is a vital factor to his country.

The enclosed letter from one of the largest independent producers in the anthracite fields is expressive and deserves the utmost consideration. The owners, Robert and Kenneth Moffat, can furnish any sound technician your committee may select, proof beyond any doubt that depletion as it stands is sound, and that it will be dangerous to private capital to interfere with the current standard.

We need more competent explorers in this field. Let us not rock the boat. Kindly make the Moffat Coal Co.

letter, and my own, a part of your record; so that they can be brought to the attention of every member of the committee.

Sincerely yours,

HARRY P. O'NEILL, M. C.

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House Hearings, 1951

(*Hearings Before the House Committee on Ways and Means on Revenue Revision of 1951*, 82d Cong., 1st Sess., pt. 3 (1951))

[1537] Statements of J. RUTLEDGE HILL, Dallas, Tex., Chairman of the Committee on Taxation, National Sand and Gravel Association, and CHARLES E. BRADY, Salisbury, N.C., Vice Chairman of the Committee on Taxation, National Sand and Gravel Association:[5]

* * * * *

Mr. HILL. In behalf of the commercial sand and gravel industry of the United States, I ask your committee to recommend to the House that sand and gravel be added to the list of nonmetallic minerals entitled to percentage depletion.

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[1538] Cost depletion does not scratch the surface of our problem. The cost of acquisition of new sand and gravel deposits, it is revealed by a sample check, has quadrupled in the past 10 years. The cost [1539] of

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[5] A portion of this statement is included in Gov't App. B, pp. 288-89.

exploration for new sand and gravel reserves have increased in the same proportion. Many companies in our industry face the problem of survival in the sand and gravel business because deposits are being exhausted at a time when new sources of supply cannot be found. I say in the utmost seriousness to your committee that cost depletion for the sand and gravel industry is wholly inadequate.

The company of which I am president has operations in the southwestern part of the United States. In the 5-year period ended December 31, 1950, we invested in exploration for, and development of, new sources of supply and in new sand and gravel reserves a sum of money greater than our depletion and depreciation reserves plus over 80 percent of our entire net profits for those 5 years.

Today we have fewer sand and gravel operations, and smaller and poorer sand and gravel reserves, than we had 5 years ago, notwithstanding the fact that military and civilian demands for sand and gravel to support a great construction program will be especially acute this year and in succeeding years. This is the story for my own company, but it is a common story for the sand and gravel industry.

Our problem is aggravated by the higher corporate, normal, surtax, and excess-profits-tax rates now in effect. These rates may be on the statute books for a long time. Yet the sand and gravel industry, if it is to do the job which the country expects, must make substantial investments for exploration and in the location and acquisition of expensive plants on uncertain and possibly poorer deposits.

Unless sand and gravel receives a percentage depletion allowance in the requested amount, there will be many parts of the United States in which commercially usable sand and gravel will not be available.

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[1542] Statement of JAMES W. HALEY, Secretary, Special Tax Committee, National Coal Association, Washington, D. C.:[6]

Mr. HALEY. * * *

[1544] We are here today to urge the Congress to reduce this inequitable treatment between coal and its competitors by increasing the depletion rate for coal to 10 percent.

* * * * *

In times of national emergency the coal industry is called upon to fuel the Nation's economy—it is the only really flexible source of fuel supply. In addition to taking care of the increased steel production and its normal markets, coal must take over many of the markets which oil and gas are in wartime unable to supply. In order that the coal industry of this Nation may maintain an economy sufficiently healthy to permit this rapid expansion, the tax structure must permit adequate reserves for the procurement of new coal lands and for the opening of new mines.

In order for capital to be available to an industry, either the rate of return must be reasonable or some return must be certain. In the coal industry there obviously is no certainty of a profit.

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[6] A portion of this statement is included in the Gov't App. B, p. 289.

Therefore, to allow this industry to remain in a position to meet the wartime needs of the Nation, the tax structure must be such as to permit a reasonable compensation for the increased use of its wasting asset—coal. A 5-percent depletion allowance is wholly inadequate.

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[1545] Raising the depletion on coal from 5 to 10 percent will be beneficial to the coal-producing industry in that it will afford to the industry an opportunity to acquire some reserve with which to maintain its physical properties. Certainly the value of coal, like the value of everything else, has increased in the last 10 years. Moreover, the acquisition and gaining of desirable coal properties has become in recent years increasingly difficult and expensive.

Raising the depletion rate for coal to 10 percent will not only remove a long standing and aggravated inequity, it will also help labor in that it will mean more running time and more employment.

Moreover, it will be beneficial to coal consumers. In the long run it will enable the coal suppliers to offer coal to consumers at a relatively lower price. Due to the highly competitive nature of the coal-mining industry, this is certain to be the case.

It should always be remembered in the case of percentage depletion that the taxpayer never gets tax exemption or a subsidy free of taxation, because such depletion allowances are under the law limited to 50 percent of the net income from the property.

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[1550] Mr. SIMPSON. * * *

Do you believe that a 5-percent increase would begin to solve the problem? I am surprised that you do not ask for 15 percent.

Mr. HALEY. Well, I think we could make a pretty good case for 15 percent, but we certainly think as a minimum 10 percent will be helpful to us.

I should like to state also that, as the Congressman no doubt realizes, the depletion is limited to 50 percent of the net income and if it were any higher than 10 percent the 50-percent limitation would limit us anyway.

Mr. SIMPSON. Now, this will cover money used for exploration and examination in seeking new sources of fuel?

Mr. HALEY. For the actual purchase of new properties. The depletion reserve is for the purpose of acquiring new properties when the current mine properties are exhausted.

Mr. SIMPSON. Is that area not being developed as it should be? That is, are you not searching now and acquiring new properties as you should, as good business would dictate?

Mr. HALEY. We certainly are. But we find every day that the depletion reserve is wholly inadequate to procure a new property.

Mr. SIMPSON. Then if we fail to increase this, we are limiting the industry in what good business would dictate as the proper amount to spend in seeking out reserves; is that correct?

[1551] Mr. HALEY. Yes, sir.

I think that is a very necessary step, particularly at this time.

Mr. SIMPSON. From a consumer's standpoint where there is the possibility of some savings in cost and from the national welfare standpoint in the interest of keeping up large reserves that are easily obtainable in bituminous coal, it would seem that this would be desirable legislation.

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[1566] Statement of PHILIP L. CORSON, G. & W. H. Corson, Inc., Plymouth Meeting, Pa.:[7]

Mr. CORSON. My name is Philip L. Corson, and I am president of G. & W. H. Corson, Inc., of Plymouth Meeting, Pa.

* * * * * *

Mr. CORSON. We manufacture lime, refractories, and limestone products from our quarry located near Philadelphia, Pa.

As a businessman I fully appreciate the problem before this committee and we in the limestone industry are perfectly willing to bear our share of whatever taxation must be imposed for the defense effort. I believe that the expansion in the limestone industry which will result from the elimination of the inequity which has so long existed—that of not being granted percentage depletion while so many other less essential minerals have received this treatment for years—will result in a greater return of revenue to the Federal Government, and, therefore, in behalf of the National Lime Associa-

[7] A portion of this statement is included in the Gov't App. B, p. 388.

tion, I am renewing its request that percentage depletion at the rate of 15 percent be provided for metallurgical and chemical limestone.

Steel is the basic sinew of war and to meet the needs of a rapidly expanding steel industry, the development and production of high grade metallurgical limestone must be greatly stepped up and expanded. Steel cannot be manufactured without limestone. There is no substitute for this basic material.

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[1567] It is therefore essential that a real incentive be furnished not only to promote the prospecting and development of new sources of limestone, [1568] but also to aid in increasing production of known deposits and to prevent the present high tax rates from actually depressing the production rate of this industry. This can be accomplished by allowing percentage depletion for chemical and metallurgical limestone; and by also according to it the same excess-profits-tax relief given to coal, metals, natural gas, and timber with excess output.

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[1571] Statement of DONALD A. CALLAHAN, Representing the American Mining Congress, Washington, D. C.:[8]

Mr. CALLAHAN. * * *

[1573] What we of the mining industry ask is that there be no curtailment of the modest depletion allowance now effective, but rather an increase in such allow-

[8] A portion of this statement is included in Gov't App. B, pp. 290-95.

ance and a liberalization of the laws applicable to mining operations so as to restore the incentive to search for and [1574] develop hidden mineral deposits and an assurance that we can go ahead in this difficult and financially hazardous business without the constant threat of impairment of our position once we have made our investments and entered upon our operations. We ask an opportunity to maintain a healthy and vigorous mining industry so vital in the present emergency and so essential to the future welfare and security of our country.

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I also ask, gentlemen, to be permitted to file a booklet on Mining Taxation, prepared by the American Mining Congress in February 1950, and a statement on "Depletion of Mines," recently prepared by the same organization.

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MINING TAXATION—CHANGES IN FEDERAL TAX LAWS NEEDED TO ENCOURAGE MINING ENTERPRISE

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The importance of encouraging mineral exploration, development, and research as a matter of national policy can hardly be overemphasized. During World War II our mines were called upon for extremely heavy production to provide the basic materials without which the war could not have been fought nor our civilian economy carried on. In meeting this enormous demand, available manpower was concentrated on production from known ore reserves, and the normal development of reserves for the future had to be sacri-

ficed. Today, in order to replace the reserves used up during the war and to maintain a strong and productive mining industry for the future, large amounts of capital must be spent in developing extensions to existing mines, in finding and bringing into production new mines, and in working out improved methods of prospecting, mining, and ore treatment. Unless this is done, our future supply of essential metals and minerals, and our national security itself, may be seriously endangered.

Tax revisions which will help remedy the present critical situation, by restoring the incentive for venture capital to undertake renewed exploration, development, and research, are accordingly matters of primary national interest. Certain important tax changes needed to accomplish this purpose are noted below. [1575] It should be emphasized that, over the long run, these changes will not reduce Government revenue; rather, by creating new mining enterprises, new employment, additional sales of machinery and supplies, additional freight traffic, and additional business for farmers, merchants, and service industries in the communities where mining operations are the chief support of whole populations, they will broaden the base of Federal taxation and add to Government revenues. On the other hand, unless such tax changes are made and the incentive for mining development restored, we must expect decreased Government revenues from the mining industry and from a large segment of our population which depends upon mining and the processing of mineral products.

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[1577] In practice, the limitation to not more than 50 percent of the net income reduces the actual depletion allowance for many mines to less than the 15 percent rate on gross income. Over a period of years, the combination of the two rates is likely to reduce the actual allowance to materially less than either of these percentage standards. In the light of experience, both the percentage of gross and the percentage of net should be increasd to give a fair allowance for depletion.

As noted earlier, only a few of the mineral properties on which large amounts are spent for development ever become profitable mines. In the great majority of cases the expenditure is a complete loss; in many others only a portion of it is ever recovered. A true base for depletion would be that method which would return to the mining industry as a whole the entire sums expended throughout the years in the search for and development of mineral properties, by both the successful and the unsuccessful ventures; and while in practice the application of such a basis would be extremely difficult, due to inadequate data, it is clear that it would result in a very large increase in present depletion rates.

The importance of adequate depletion allowances as an incentive for venture capital in the mining industry can hardly be overstressed; and it is strongly urged that the modest rates allowed under the present law be raised, by increasing both the present percentage of gross income and the present limitation in reference to net income.

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[1579] This is a complex subject, involving various technical features of the present law. In particular the percentage depletion provisions, intended to be simple and easy of application, have been subject to a series of interpretations which tend to create uncertainty and to reduce the allowance that Congress originally intended. Some of these interpretations have become established by Treasury regulations or practice to such an extent that amendment of the law is needed to correct the situation.

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[1579] DEPLETION OF MINES

(A statement by the mining industry)

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[1582] *5. The Present need*

Public policy recognizes the importance to our country of a continuous flow of minerals from the mines to the consumers. Minerals are the backbone raw materials for our industrial civilization, indispensable to our welfare and progress in time of peace, vital to our security in time of emergency. The recent war caused vast drains upon our best mineral reserves, and current demands cannot be measured by prewar levels.

Clearly, it is imperative that the search for new and greater mineral reserves be accelerated; that every serious deterrent to this objective be eliminated; that every reasonable incentive toward it be created.

The search for new mines is no longer the simple task of the lone prospector; the easily discovered deposits, for the most part, have already been found.

Applied science and engineering of high order are required in modern prospecting and exploration. The cost of finding and bringing new mines into production has expanded enormously in the last decade. The successful search for, exploration, and development of new mines today depends mainly upon the established mining companies, with trained personnel and ample financial resources and equipment.

Adequate depletion allowances are absolutely essential, if funds are to be available for the continued discovery and development of mineral supplies to replace the reserves being depleted and to increase our mineral supplies to support our expanding population and maintain our rising standard of living.

Percentage-depletion allowances available to producers of many important minerals are wholly insufficient to supply the large volume of funds now required for this purpose. Not only should the principle of percentage depletion be preserved intact, but the allowances should be liberalized to more nearly permit capital recovery and to encourage and stimulate exploration and development activities commensurate with our national mineral requirements.

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[1608] Statement of JAMES A. WHITE, Secretary, National Minerals Advisory Council, Washington, D. C.:

Mr. WHITE. My name is James A. White. I am secretary of the National Minerals Advisory Council and I am here at the request of Mr. Albright, who is at present on the west coast and is unable to be in Washington today to appear before your committee on be-

half of the Council. He has asked me to present to you his prepared statement setting forth the views of the Council on taxation as it relates to mining and containing recommendations of the Council pertinent thereto.

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[1609] (The statement of Mr. Albright follows:)

STATEMENT OF HORACE M. ALBRIGHT, CHAIRMAN, NATIONAL MINERALS ADVISORY COUNCIL

The National Minerals Advisory Council was established and its members appointed by the Secretary of the Interior in December 1947 to advise the Secretary on mining problems and mineral policy. The Council is composed of 46 members and represents a cross section of the domestic mining industry. Serving on the Council are both large and small producers of the various metals and minerals, other than mineral fuels. Members of the Council are chosen in consideration of their experience and knowledge of mining problems and their interest in developing a national minerals policy.

Since its inception the Council has been concerned vitally with the problem of taxation as it relates to mining. The subject of taxation attracted the attention of the Council when it began to inquire into the reasons for the languishment of exploration and development work which has been so apparent in the United States in the past decade.

The Council has on numerous occasions in the recent past expressed its belief that present tax laws deter investment of venture capital in new mining enterprise.

On December 7, 1949, after prolonged study, the Council presented to the Secretary of the Interior several recommendations on tax revision which, if enacted into law, would aid materially in the exploration for and development of new mineral deposits. I appeared before your committee on February 9, 1950, on behalf of the Council in support of those recommendations. Your committee permitted me to insert in the record at that time those recommendations along with an explanatory memorandum and my letter of transmittal to the Secretary of the Interior.

At a meeting on August 3, 1950, the Council again urged most of the original tax revision recommendations.

At its most recent meeting on January 29, 1951, the Council affirmed its confidence in the efficacy of four of the original recommendations designed to stimulate sorely needed exploration and development work in mines. Those four recommendations, with accompanying explanations, are as follows:

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[1610] (4) Adequate allowances for percentage depletion should be made.

It is with this last recommendation that we are here concerned.

I know the committee desires to confine the scope of the testimony presented today to a discussion of depletion allowance for mines. But I wish to take the opportunity to mention once again the tax-revision recommendations alluded to above because the Council has reiterated those recommendations on two different

occasions since I appeared before this committee last. The Council believes today, as it did a year ago, that the above recommendations, if enacted into law, would provide the incentive needed to increase exploration for and development of new mineral reserves. For that reason I feel it necessary to again bring those recommendations to the attention of this committee and to urge their favorable consideration.

The President inferred in his tax message to the Congress on February 2, 1951, much the same as he did in January 1950, that the depletion allowance granted to certain segments of the mining industry was a tax "loophole" and as such should be discontinued. I do not intend at this time to embark upon an exhaustive discussion of the apparent misconception upon which the President's language is based, but I do wish to point out the necessity for at least safeguarding the percentage-depletion provisions now in our tax laws.

After years of experience with other methods of computing depletion Congress, in 1932, wrote into the law the present percentage method for metal mining, coal, and sulfur. This action showed congressional recognition of the principle that capital should not be taxed as income. The method adopted was a fair and simple means of measuring the value of the miner's wasting asset during the life of his mine. Percentage depletion has subsequently been extended to certain other minerals.

The rates established and the principle behind them have been attacked several times since 1932, but Congress has remained steadfast in its supoprt of them. The attacks on the depletion-allowance provision have

been largely the result of claims of discrimination in our tax laws in favor of mining interests. Such attacks stem from a misunderstanding of the mining process and a tendency to liken mining to manufacturing. Briefly, a manufacturer can replace his [1611] raw materials through open-market purchases while a miner exhausts his raw materials and can only replace them through the expensive process of search for and development of new deposits. The miner is, therefore, committed to the process of continual search for new mineral wealth to replace his depleting capital.

The opponents of percentage depletion appear to be inclined to exaggerate the wealth of the mining industry while observing the taxable income of only a few highly successful operations. To get a true picture we must look at the whole of the mining industry. The great majority of mining enterprises are a financial failure. Approximately nine-tenths of all mining ventures are unsuccessful and the cost of these failures must be included in the cost of the deposits that may be successfully developed. The income of the industry as a whole is the combined net profit and loss of all mining properties.

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[1618] Statement of CHARLES E. GLASSER, President, General Reduction Co., Chicago, Ill.:[9]

Mr. GLASSER. I am Charles E. Glasser, president of the General Reduction Co., Chicago, Ill. Our com-

[9] A portion of this statement is included in Gov't App. B pp. 352-53.

pany mines fuller's earth at Macon, Ga. I respectfully request the adoption of a depletion of 15 percent of gross income for fuller's earth mining operations, or a percentage amount equal to that given many other similar nonmetallic clays and minerals.

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[1619] The search for new fuller's earth areas is a risky enterprise, entailing the hazard of large investments of risk capital. Such ventures may be unsuccessful because the deposits are far below the surface of the earth and are nonuniform both as to quality and thicknesses of strata. Geological surveys, aerial mapping, as well as drilling and excavating are costly. Hence, from an investor's standpoint it is vitally necessary that provisions be made which will make adequate allowances for the hazards in mining of fuller's earth and leave an incentive for continued investment of venture capital in other areas. The adoption of 15-percent depletion for fuller's earth would at least provide a minimum incentive for such venture capital.

We understand the Treasury Department has reported before your committee that on the basis of unit costs per ton—a method sometimes used—depletion for nonmetallic minerals mining operations average around 1 cent per ton. On this basis and using the figure of 320,906 tons of fuller's earth mined in 1949 as reported by Bureau of Mines, total depletion would be $3,209.06 for the entire fuller's earth industry. Gentlemen, I ask you, how much, if any, exploration and initial work could be done even if one company was privileged to spend this entire amount?

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[1621] Statement of FRED O. DAVIS, Vice President and Treasurer, Potash Co. of America, Carlsbad, N. Mex.:[10]

Mr. DAVIS. My name is Fred O. Davis, vice president and treasurer of the Potash Co. of America located at Carlsbad, N. Mex. This statement is submitted in behalf of the Potash Co. of America and other producers of potash in the United States.

* * * * *

It has previously been stated that a stable basis of percentage depletion would result in extensive exploratory work with the probability of new discoveries being made. This statement is still true and the situation is of utmost importance because of the restricted area in which potash has been found to occur. The logical character of this reasoning is exemplified by the fact that within the last 3 years two more deposits of commercially exploitable potash have been discovered in the Carlsbad, N. Mex., area and two tremendous operations for refining the product are currently under construction. The experience of these two operators is typical of the precarious nature of the deposits and the enormous investment required to find and develop the mineral.

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[1623] The elimination of percentage depletion for potash or a drastic reduction therein as is recommended by the Treasury Department would hinder and perhaps

[10] A portion of this statement is included in Gov't App. B, p. 406.

prevent the continued exploration for and development of potash deposits which are so vital to the Nation's economy.

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[1625] The stability of the industry over the years has been a major factor in its records of constant growth and in the development of additional reserves, and it is a grave question as to whether the costly exploratory work by existing or potential producers could or would have been undertaken if there had been any question concerning the continuance of the present percentage-depletion rate which was granted to the industry after comprehensive study as recently as 1943. There is no question that further operations, in the light of the now necessary tremendous capital investment, will be greatly discouraged if downward changes are made in depletion rates. It is also highly important that rates, once established, should not constantly be subject to change, as any program of development in the mining industry must, of necessity, be long range in character.

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[1626] Mr. SIMPSON. Do you believe that if the depletion allowance were cut there would not be sufficient expansion to keep up with our domestic demands in wartime?

Mr. DAVIS. I think there is a very good chance that it would discourage expansion or discourage exploration of the type which has taken place during the last 3 or 4 years and which has resulted in two more companies being ready to enter the field.

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[1631] Statements of RUSSELL RAREY, President, Marble Cliff Quarries Co., Columbus, Ohio, and HORACE C. KRAUSE, President, Columbia Quarry Co., St. Louis, Mo.: [11]

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[1635] Mr. KRAUSE. My name is Horace C. Krause, president of the Columbia Quarry Co., St. Louis, Mo. I am chairman of the Percentage Depletion Committee for the National Crushed Stone Association and the Agricultural Limestone Institute.

* * * * *

[1635] There are many considerations which make a stone deposit unfit for profitable commercial use, such as lack of economical transportation, lack of ready access to highways, failure to comply with State and Federal requirements for construction, failure to meet chemical and physical requirements of industry and consumers, and structural or geological characteristics which render the stone unfit for commercial recovery. There are other minor but important technical reasons why so few stone deposits are suitable. Most quarries now in use were discovered by trial and error or by accident, and with the present high costs of opening a quarry it cannot be done on a trial-and-error basis.

The industry therefore needs the benefit of percentage depletion to assist in exploration costs. Without percentage depletion, the [1636] industry does not have an adequate profit to satisfactorily prospect for and acquire future stone deposits.

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[11] A portion of these statements is included in Gov't App. B. pp. 373-76.

[1640] Statement of RICHARD BUTLER CAROTHERS of the H. C. Spinks Clay Co., Paris, Tenn.:

Mr. CAROTHERS. Mr. Chairman and gentlemen, my name is Richard Butler Carothers. I represent the H. C. Spinks Clay Co., Paris, Tenn.

* * * * * *

[1645] I wish to dispute one thing that the Secretary of the Treasury has said about depletion. In his statement to this committee, Mr. Snyder says:

> The Federal income tax recognizes depletion of wasting mineral assets as a deductible cost in determining net taxable income. The depletion allowance for mineral resources corresponds in principle to the depreciation allowance for plant and equipment.

Now, gentlemen, I am not a lawyer, but I am a clay digger, and I have to buy the equipment to dig this clay with, and I have to pay for it, and I know that percentage depletion is a far different operating matter than depreciation on your plant and equipment. When you buy a truck you have a definite cost on that truck. Under the income-tax law you depreciate that truck over its normal life and you know when you take that money that you have set up there to replace that truck, exactly what you can buy with that money. You know how big a truck you can buy, what size it will be, what tonnage it will haul, and how fast it will run. But when you take your depletion allowance and set it aside, as our companies do, and use that money to look for more deposits and more clay, you do not know the

definite cost of these deposits that you are attempting to get. Many times you spend that depletion allowance during a year's operation and you do not get any deposits.

Sometimes you are lucky and you do very well. But there is an extreme element of risk in the ball-clay industry, and I think you gentlemen certainly see the difference between depreciation and depletion as far as our industry is concerned.

* * * * *

[1645] The CHAIRMAN. Mr. Simpson.

Mr. SIMPSON. Mr. Carothers, you always contribute something to the committee's thinking when you come before us, and I am always glad to see you here.

The last statement you made is one that should concern the committee quite materially. The fact is that you have, as a result of the depletion allowance, been able to do more exploratory work and I infer that you have been successful.

[1646] Mr. CAROTHERS. We have found some deposits, the various companies have.

Mr. SIMPSON. That the industry might not have found if you had not had the depletion allowance?

Mr. CAROTHERS. I do not believe that some of them would have been financially able to do the work.

Mr. SIMPSON. After all, particularly with respect to any industry connected with the defense of the country, that is the real test, as I see it, of whether we should allow a depletion allowance.

* * * * *

Ways and Means Press Releases, 1954

(Committee on Ways and Means, House of Representatives, Press Releases, 1954 (concerning the drafting of the Internal Revenue Code of 1954))

Press Release #24, February 18, 1954

Chairman Daniel A. Reed announced that the following substantive changes were agreed to by the Committee on Ways and Means in the Revenue Revision Bill of 1954:

* * * * *

2. *Definition of Gross Income from Property.* Under present law and the bill, the percentages referred to in No. 1 above are applied to "gross income from the property." This is defined as gross income from mining, and "mining" in turn is defined as the extraction of the minerals, ordinary treatment processes normally applied to obtain commercially marketable mineral products and certain transportation. Present law also lists a number of specific processes that are considered to be ordinary treatment processes.

The bill contains these definitions except in three respects. In the case of brick and tile clay, crushing, granulating, disintegrating, rolling, tempering and removing air are considered part of "ordinary treatment processes." (However, molding, shaping, extruding, firing or burning are not.) In the case of magnesite, the burning is treated as an ordinary treatment process and in the case of talc fine pulverizing is to be treated as such a process.

The present law is not specific as to what constitutes ordinary treatment processes in the case of brick and tile clay but has been interpreted in the same way as specifically provided by the Committee's bill.

* * * * *

Press Release #27, February 24, 1954

Chairman Daniel A. Reed announced that the following substantive changes were agreed to by the Committee on Ways and Means in the Revenue Revision Bill of 1954:

I. PERCENTAGE DEPLETION.—

The Committee reconsidered a previous decision it made with respect to percentage depletion on brick and tile clay. Previously the Committee had agreed to include a specific provision in the bill that ordinary treatment processes with respect to brick and tile clay were not to include "molding, shaping, extruding, firing, or burning," in order to resolve a question which exists under present law. The Committee agreed not to include this specific phrase, thus leaving the treatment of these processes to be determined under existing law.

* * * * *

(INT. REV. CODE OF 1954, §§ 611-13, 68A Stat. 3, 207-08)

SEC. 611. ALLOWANCE OF DEDUCTION FOR DEPLETION.

(a) GENERAL RULE.—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate. For purposes of this part, the term "mines" includes deposits of waste or residue, the extraction of ores or minerals from which is treated as mining under section 613 (c). In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this section for subsequent taxable years shall be based on such revised estimate.

(b) SPECIAL RULES.—

(1) LEASES.—In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee.

(2) LIFE TENANT AND REMAINDERMAN.—In the case of property held by one person for life with remainder to another person, the deduction under this sec-

tion shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant.

(3) PROPERTY HELD IN TRUST.—In the case of property held in trust, the deduction under this section shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

(4) PROPERTY HELD BY ESTATE.—In the case of an estate, the deduction under this section shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of the income of the estate allocable to each.

(c) CROSS REFERENCE.—

For other rules applicable to depreciation of improvements, see section 167.

SEC. 612. BASIS FOR COST DEPLETION.

Except as otherwise provided in this subchapter, the basis on which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain upon the sale or other disposition of such property.

SEC. 613. PERCENTAGE DEPLETION.

(a) GENERAL RULE.—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the

percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

(b) PERCENTAGE DEPLETION RATES.—The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

(1) 27½ percent—oil and gas wells.

(2) 23 percent—

(A) sulfur and uranium; and

(B) if from deposits in the United States—anorthosite (to the extent that alumina and aluminum compounds are extracted therefrom), asbestos, bauxite, beryl, celestite, chromite, corundum, fluorspar, graphite, ilmenite, kyanite, mica, olivine, quartz crystals (radio grade), rutile, block steatite talc, and zircon, and ores of the following metals: antimony, bismuth, cadmium, cobalt, columbium, lead, lithium, manganese, mercury, nickel, platinum and platinum group metals, tantalum, thorium, tin, titanium, tungsten, vanadium, and zinc.

(3) 15 percent—ball clay, bentonite, china clay, sagger clay, metal mines (if paragraph (2)(B) does not apply), rock asphalt, and vermiculite.

(4) 10 percent—asbestos (if paragraph (2)(B) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite.

(5) 5 percent—

(A) brick and tile clay, gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6); and

(B) if from brine wells—bromine, calcium chloride, and magnesium chloride.

(6) 15 percent—all other minerals (including, but not limited to, aplite, barite, borax, calcium carbonates, refractory and fire clay, diatomaceous earth, dolomite, feldspar, fullers earth, garnet, gilsonite, granite, limestone, magnesite, magnesium carbonates, marble, phosphate rock, potash, quartzite, slate, soapstone, stone (used or sold for use by the mine owner or operator as dimension stone or ornamental stone), thenardite, tripoli, trona, and (if paragraph (2)(B) does not apply) bauxite, beryl, flake graphite, fluorspar, lapidolite, mica, spodumene, and talc, including pyrophyllite), except that, unless sold on bid in direct competition with a bona fide bid to sell a mineral listed in paragraph (3), the percentage shall be 5 percent for any such other mineral when used, or sold for use, by the mine owner or operator as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. For purposes of this paragraph, the term "all other minerals" does not include—

(A) soil, sod, dirt, turf, water, or mosses; or

(B) minerals from sea water, the air, or similar inexhaustible sources.

(c) DEFINITION OF GROSS INCOME FROM PROPERTY.—For purposes of this section—

(1) GROSS INCOME FROM THE PROPERTY.—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) MINING.—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

(3) EXTRACTION OF THE ORES OR MINERALS FROM THE GROUND.—The term "extraction of the ores or minerals from the ground" includes the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining. The preceding sentence shall not apply to any such extraction of the mineral or ore by a purchaser of such waste or residue or of the rights to extract ores or minerals therefrom.

(4) ORDINARY TREATMENT PROCESSES.—The term "ordinary treatment processes" includes the following:

(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process—pumping to vats, cooling, breaking, and loading for shipment;

(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of the crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment;

(D) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores; and

(E) the pulverization of talc, the burning of magnesite, and the sintering and nodulizing of phosphate rock.

House Hearings, 1958

(*Hearings Before the House Committee on Ways and Means on General Revenue Revision*, 85th Cong., 2d Sess., pt. 1 (1958))

[1095] Statement of Hon. ROBERT B. ANDERSON, Secretary of the Treasury

Secretary ANDERSON. * * *

[1097] Last October, the Supreme Court denied a petition for certiorari in a series of cases dealing with the so-called cutoff point for percentage depletion in the manufacture of bricks and cement.

The net result of the cases is to apply the percentage depletion allowance to the price of finished manufactured products, bricks and cement, rather than to the value of the clay and the cement rock before it is manufactured.

In both cases, the effect of the decision is to increase the depletion deductions severalfold over the amounts previously allowed under Treasury regulations. While we support the principle of depletion for these materials, we do not believe that depletion on this scale is reasonable or was intended.

[1098] The problem appears to arise from the application of the phrase "the commercially marketable mineral product or products" in the statute. I recommend the law be revised to prevent these excessive depletion deductions. The revenue loss in the two industries directly covered by the cases is about $50 million a year.

* * * * *

Treasury Proposal, 1958

(Committee on Ways and Means, House of Representatives, Press Release of April 25, 1958 (concerning the Treasury Department's proposed legislation relating to percentage depletion allowances for the brick and cement industries))

Chairman Wilbur D. Mills (D., Ark.), Committee on Ways and Means, today released a letter from the Treasury Department, along with the Department's proposed draft of legislation, relating to percentage depletion allowances for the brick and cement industries.

Chairman Mills stated:

"I am today releasing a letter and proposed draft of legislation from the Treasury Department relating to percentage depletion allowances for the brick and cement industries. It will be recalled that on January 16, 1958, during Secretary Anderson's appearance before the Committee on Ways and Means wherein he testified on general tax revision, he recommended that legislative changes be made in the allowance of percentage depletion for the brick and cement industries. The attached letter, along with the attached proposed legislation, is designed to carry out the Secretary's recommendation.

"I am releasing this letter and proposed draft of legislation so that they may be available to the interested public.

"It is my expectation that before any action is taken the Committee will hold one day of public hearings on this proposal, at which representatives of the Treasury

Department and the interested public will be permitted to testify. Persons who may be interested in appearing and testifying should submit their requests to the Clerk, Committee on Ways and Means, Room 1102, New House Office Building, as soon as possible. Such persons will be notified of the date for the hearings as soon as it is determined. However, due to the fact that the Committee has a very heavy schedule for the remainder of this session of the Congress and can allow only one day for these hearings, it is very important that interested persons coordinate their testimony and request the appearance of only that number of witnesses who will be able to present such coordinated testimony in one day.

"With this in mind it is suggested that the interested persons consider the advisability of making some arrangement to coordinate their requests to the Clerk so that the Committee will not have the burden of selecting witnesses and alloting time to witnesses since the Committee feels that the interested persons are in a better position to do so. For guidance in such efforts, not to exceed one hour will be allowed representatives of the Treasury Department and not to exceed two hours for the interested public witnesses. This time allocation is for direct testimony of the witnesses. It does not take into account time for questions by Members of the Committee."

The Treasury Department letter and proposed draft of legislation follow.

"TREASURY DEPARTMENT
Washington

APR 24, 1958

"My dear Mr. Chairman:

"Secretary Anderson, in testimony before your Committee on January 16, 1958, recommended that the law be revised to preclude the allowance of excessive depletion deductions for the brick and cement industries. His recommendation resulted from the Supreme Court's denial of a petition for certiorari in a series of cases involving manufacturers of bricks and cement which held that a taxpayer may compute percentage depletion on the basis of the selling price of the finished manufactured product rather than on the value of the clay or the cement rock before it is manufactured. It is estimated with respect to the two industries directly covered by the cases that excessive depletion allowances will result in a revenue loss of approximately $50 million a year.

"Courts have consistently found that the statute entitles taxpayers who are extracting minerals to compute their gross income from the property by including the treatment processes which mine operators would normally apply to obtain the first marketable product. The Government has contended that only concentration processes equivalent to those specifically named in the statute for certain minerals are mining processes and hence allowable, whereas manufacturing processes are not allowable. The result of the court decisions is that a taxpayer who extracts the mineral from the ground and applies processes thereto may base his

depletion allowance on income from the commercially marketable product, regardless of whether or not his processes are manufacturing processes. It is believed that depletion on this scale is excessive and was not intended.

"The enclosed proposed legislation would carry out the Secretary's recommendation, with respect to the clay and cement industries, and adopt the prior practice of the Department by delineating between mining and manufacturing processes. The bill specifies the processes allowable in determining a taxpayer's gross income from mining at a cut-off point which with respect to clay products would end with crushing and grinding, and, if the clay were sold in the form of the crude mineral, loading for shipment. The proposed legislation in addition would provide that clay, when used to manufacture building brick and tile products, shall be limited to the depletion rate of 5 percent. Otherwise, clays other than ordinary clay would obtain a distinct competitive advantage when used to manufacture common building products.

"The bill also provides a definition of ordinary treatment processes in the case of calcium carbonates, shale, and other minerals used in integrated operations to manufacture cement. The cut-off point with respect to these minerals is again consistent with prior practice.

"The bill does not affect limestone, calcium carbonates, or shale used for purposes other than making cement.

"The enclosed bill would restore a reasonable allowance of depletion for the cement and clay products industries and, at the same time, provide a statutory

solution for administrative difficulties faced in determining for different taxpayers the stage at which taxpayers first obtain a commercially marketable mineral product.

"In the absence of further legislation providing a specific cut-off point for other minerals and ores, this Department will continue to face substantial problems in determining for many mineral industries the stage at which taxpayers first obtain a commercially marketable mineral product. There is, for example, a question as to whether the stage should be determined by reference to the taxpayer's own local market or the national market. In some cases the local market approach would have the effect of obtaining a different cut-off for the same mineral in different areas of the United States. On the other hand, the national market approach, while establishing a uniform first commercially marketable product for an entire industry, would be difficult to apply in instances where there is no readily available data with respect to the minerals concerned. Moreover, there is a question as to whether the courts would accept the national market approach as the correct construction of the statute.

"As noted, the enclosed bill provides a statutory solution only for the cement and clay products industries. This is the immediate need in view of the recent series of cases dealing with the cut-off point for percentage depletion in the manufacture of bricks and cement.

"The Treasury is prepared to furnish you and the Committee such assistance as you may suggest in resolving further difficulties in this area.

"The Director, Bureau of the Budget, has advised

the Treasury Department that there is no objection to the submission of this proposed legislation.

"Sincerely yours,

(signed) DAN THROOP SMITH,
Deputy to the Secretary.

"Honorable Wilbur D. Mills
Chairman, Committee on Ways and Means
House of Representatives
Washington 25, D. C.
Enclosures"

A BILL to specify processes which shall be considered mining for the purpose of computing depletion in the case of clay and in the case of minerals used in making cement.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DEPLETION RATE FOR CERTAIN CLAYS AND ALLOWABLE PROCESSES FOR COMPUTING DEPLETION ON CERTAIN MINERALS.

(a) DEPLETION RATE FOR CERTAIN CLAYS.—Subsection (b) of section 613 (relating to percentage depletion rates) is amended as follows:

(A) Paragraph (3) is amended to read as follows:

"(3) 15 percent—

"(A) metal mines (if paragraph (2)(B) does not apply), rock asphalt, and vermiculite; and

"(B) if paragraph (5)(B) does not apply, ball

clay, bentonite, china clay, sagger clay, and clay used, or sold for use, for purposes dependent on its refractory properties."

(B) Paragraph (5) is amended to read as follows:

"(5) 5 percent—

"(A) gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6);

"(B) clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products; and

"(C) if from brine wells—bromine, calcium chloride, and magnesium chloride."

(C) Paragraph (6) is amended by striking "refractory and fire clay,".

(b) CERTAIN ORDINARY TREATMENT PROCESSES—Subsection (c) of section 613 (relating to the definition of gross income from property) is amended as follows:

(A) Subparagraph (C) of paragraph (4) is amended by striking "ball and sagger clay,".

(B) Paragraph (4) is amended (i) by striking the word "and" at the end of subparagraph (D), (ii) by inserting a semicolon in lieu of the period at the end of subparagraph (E), and (iii) by adding at the end thereof the following new subparagraphs:

"(F) In the case of clay—crushing and grinding, and separating the mineral from waste (and, if sold in the form of the crude mineral product,

loading for shipment), but not including as an ordinary treatment process tempering (and other methods of obtaining plasticity), molding or any subsequent process; and

"(G) In the case of calcium carbonates, shale, and other minerals used in making cement—crushing and grinding (including the filtering of slurry in the wet process) prior to burning in the kiln, but not including as an ordinary treatment process burning in the kiln or any subsequent process."

SECTION 2. EFFECTIVE DATE.

The amendments made by this Act shall be applicable only with respect to taxable years beginning after December 31, 1957.

Presidential Budget for 1960—Message from the President of the United States (H. R. Doc. No. 15)

(105 CONG. REC. 816, 817-18 (1959))

[751] FEDERAL BUDGET FOR 1960—MESSAGE FROM THE PRESIDENT OF THE UNITED STATES (H. DOC. NO. 15)

* * * * *

To the Congress of the United States:

* * * * *

[753] I urge the Congress to take action now on certain specific changes to maintain or increase revenues and to make the laws more equitable. . . . The Treasury will also recommend an amendment specifying the treatment processes which shall be considered mining

for the purpose of computing percentage depletion in the case of mineral products. This amendment, prompted by court decisions, is designed to prevent an unintended extension of percentage depletion allowances to the sales price of finished products; a similar recommendation with respect to cement and clay products was made to the Congress last year.

* * * * *

Treasury Proposal, 1959

(Committee on Ways and Means, House of Representatives, Press Release of February 12, 1959 (concerning the Treasury Department's proposed draft of legislation specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of mineral products.))

CHAIRMAN WILBUR D. MILLS (D.-ARK.), COMMITTEE ON WAYS AND MEANS, HOUSE OF REPRESENTATIVES, RELEASES TREASURY DEPARTMENT'S PROPOSED DRAFT OF LEGISLATION SPECIFYING THE TREATMENT PROCESSES WHICH SHALL BE CONSIDERED MINING FOR THE PURPOSE OF COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERAL PRODUCTS

Chairman Wilbur D. Mills (D.-Ark.), Committee on Ways and Means, House of Representatives, today released the attached letters from the Secretary of the Treasury to the Speaker of the House of Representatives, dated January 26, 1959, and February 11, 1959, respectively, and the proposed draft of legislation sub-

mitted by the Treasury Department specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of mineral products.

It will be recalled that Chairman Mills announced on February 9, 1959, that hearings have been scheduled by the Committee on Ways and Means to receive testimony on this subject, and that the Chairman stated in that press release that the Treasury's draft of proposed legislation would be made available when received.

Chairman Mills emphasized that the testimony during the hearings would be limited to the area covered by the specific recommendations of the Secretary of the Treasury.

THE SECRETARY OF THE TREASURY
Washington

JAN 26, 1959.

My dear Mr. Speaker:

In the Budget Message of the President, submitted to Congress on January 19, 1959, the President stated that the Treasury Department would recommend an amendment to the Internal Revenue Code specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of mineral products.

Early last year I testified before the Ways and Means Committee on the need to revise the law in order to preclude excessive depletion deductions for the brick and cement industries. My recommendation was made

as a result of a series of court cases which permitted manufacturers of brick and cement to compute percentage depletion on the basis of the selling price of the finished manufactured product rather than on the value of the clay or cement rock before it is manufactured.

It is now apparent under the court decisions that manufacturers of many other products may obtain depletion allowances based on gross income derived from the sale of finished products. This can only result in increasing the depletion deduction for all minerals severalfold—in extreme cases as much as one hundred times. I do not believe that depletion on such an inflated scale is either reasonable or was intended. If permitted, the revenue losses will indeed be serious.

The problem arises because the term "mining" is defined in the statute to include the ordinary treatment processes normally applied to obtain the "commercially marketable mineral product or products" which, in many instances, may be an expensive finished product. Accordingly, in order to prevent excessive depletion allowances, I recommend the immediate elimination of the phrase "commercially marketable mineral product or products" from the statute and the substitution of a new definition of "mining" which will specify the allowable treatment processes for the various minerals.

The proposed legislation would not only prevent a substantial loss in revenue but would also help resolve difficult and complex problems in determining for many mineral industries the stage at which taxpayers first obtain a commercially marketable mineral product.

The Staff of the Treasury is now preparing a draft of the proposed legislation, and in this connection would be pleased to work in cooperation with the Ways and Means Committee staff and the Joint Committee staff in its development.

Sincerely yours,

/s/ ROBERT B. ANDERSON,
Secretary of the Treasury.

Honorable Sam Rayburn,
Speaker of the House of Representatives,
Washington 25, D. C.

THE SECRETARY OF THE TREASURY
Washington

FEB 11, 1959.

My dear Mr. Speaker:

On January 26, 1959, I wrote you concerning the need for an amendment to the Internal Revenue Code specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of minerals. The enclosed draft of proposed legislation would implement the recommendations which I made in that letter for minerals.

During the consideration of this legislation by the Congress we shall continue to work cooperatively with the Congressional tax staffs in the development of the legislation, with particular reference to making certain that appropriate treatment is given all affected industries.

It would be appreciated if you would lay the proposed legislation before the House of Representatives. A similar proposal has been submitted to the President of the Senate.

Sincerely yours,

(signed) ROBERT B. ANDERSON,
Secretary of the Treasury.

Honorable Sam Rayburn,
Speaker of the House of Representatives,
Washington 25, D. C.

A BILL

To specify processes which shall be considered mining for the purpose of computing percentage depletion in the case of minerals and ores, and to revise the depletion rates with respect to certain clays when used to make common brick and tile products.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DEPLETION RATE FOR CERTAIN CLAYS AND TREATMENT PROCESSES CONSIDERED AS MINING FOR COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERALS AND ORES.

(a) Depletion Rate for Certain Clays.—Subsection (b) of section 613 (relating to percentage depletion rates) is amended as follows:

(1) Paragraph (3) is amended to read as follows:

"(3) 15 percent—

"(A) metal mines (if paragraph (2) (B) does not apply), rock asphalt, and vermiculite; and

"(B) if paragraph (5) (B) does not apply, ball clay, bentonite, china clay, sagger clay, and clay used or sold for use for purposes dependent on its refractory properties."

(2) Paragraph (5) is amended to read as follows:

"(5) 5 percent—

"(A) gravel, mollusk-shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6);

"(B) clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products; and

"(C) if from brine wells—bromine, calcium chloride, and magnesium chloride."

(3) Paragraph (6) is amended by striking "refractory and fire clay,".

(b) Treatment Processes Considered as Mining.—Subsection (c) of section 613 (relating to the definition of gross income from property) is amended as follows:

(1) Paragraph (2) is amended to read as follows:

"(2) Mining.—The term 'mining' means the extraction of the ores or minerals from the ground, the treatment processes considered as mining described in para-

graphs (3) and (4), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported to a greater distance to such plant or mills."

(2) Paragraph (3) is redesignated paragraph (5).

(3) Paragraph (4) is deleted and the following paragraphs are inserted in lieu thereof:

"(3) Treatment processes considered as mining.—The following treatment processes where applied by the mine owner or operator with respect to the minerals or ores extracted from the ground by him shall be considered as 'mining':

"(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

"(B) In the case of sulfur recovered by the Frasch process—pumping to vats, cooling, breaking, and loading for shipment;

"(C) In the case of all other minerals or ores—(i) where applied to crude minerals or ores—crushing, grinding, sorting, screening, washing, and drying to remove free moisture; (ii) beneficiation by concentration, and the processes necessary thereto; (iii) beneficiation by cyanidation, leaching, crystallization, or precipitation, and the processes necessary thereto; (iv) any additional process, if necessary, to

bring the mineral or ore to form and condition suitable for shipment; and (v) loading for shipment. For purposes of this subparagraph, the term 'beneficiation by concentration' means the application of processes solely for the purpose of eliminating waste, or separating the mineral or ore from other minerals or ores, by gravity, flotation, amalgamation, electrostatic means, magnetic means, or substantially equivalent processes. The processes referred to in (iv) are those processes which are necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore saleable. The term 'loading for shipment' shall not include the cost of packaging unless otherwise provided for under (iv), nor shall it include the cost of containers, bags, or any similar items;

"(D) The pulverization of talc, the burning of magnesite, the furnacing of quicksilver ores, and the sintering and nodulizing of phosphate rock.

"(4) Treatment processes not considered as mining.—The following treatment processes shall not be considered as 'mining':

"(A) In the case of all minerals or ores—electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping, unless such processes are otherwise provided for in paragraph (3); and

"(B) Notwithstanding any other provisions of this subsection, any treatment process which follows a process that is not considered as 'mining' will not be considered as mining for the purpose of this subsection."

SEC. 2. EFFECTIVE DATE

The amendment made by this Act shall be applicable only with respect to taxable years beginning after December 31, 1958.

Part D: Miscellaneous Materials

Material Submitted to the Treasury Department by the American Mining Congress Concerning Tentative Regulations Defining "Gross Income from the Property" Under the Revenue Act of 1932 [1]

November 23, 1932.

The Honorable James H. Douglas,
Assistant Secretary of the Treasury,
Treasury Department,
Washington, D. C.

My dear Mr. Douglas:

Regulations, Mine Depletion, Revenue Act of 1932

Attached are three copies of the Brief prepared by the Executive Tax Committee of the American Mining Congress and signed by its Chairman, Mr. H. B.

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[1] In its brief (p. 55 n.2), the Government quotes the memorandum written by Mr. Fernald and dated November 29, 1932. It does not, however, include the rest of the memorandum in its Appendix B. In order to explain in full the American Mining Congress' position, the entire correspondence is set forth here.

Fernald, as the result of the conference which you so kindly granted on November 18th at 2 P.M.

There are some other matters embodied in the tentative regulations which we had hoped to cover but could not do so in the limited time. We may wish to submit further memoranda on some of these other points within the next few days.

Thanking you for your courteous consideration of the problems of the Mining Industry, and trusting that you will at all times feel free to command this office, we remain,

Faithfully yours,

THE AMERICAN MINING CONGRESS,
By: A. W. DICKINSON.

TREASURY DEPARTMENT
Bureau of Internal Revenue

In the Matter
of the
APPLICATION OF PERCENTAGE DEPLETION

MEMORANDUM ON BEHALF OF THE AMERICAN MINING CONGRESS

This statement is addressed to the question of the proper interpretation which should be given in the forthcoming Treasury Regulations to the phrase "gross income from the property", as used in Section 114(b)(4) of the Revenue Act of 1932.

The provision for percentage depletion for coal and metal mines and sulphur, first appears in the Rev-

enue Act of 1932. Its essential wording (omitting parts not essential to this discussion) is as follows:

Sec. 114 (b) (4):

> "Percentage Depletion for Coal and Metal Mines and Sulphur.—The allowance for depletion shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income as [sic] amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, * * *."

In a tentative draft for the Regulations, which we have been permitted to see,—but with the understanding that it is merely a proposal, not carrying any final authority and quite subject to revision and modification,—we find it is proposed in Art. 221 (g) to interpret the phrase "gross income from the property" to mean the market or field price of the crude mineral product at the mine. It is proposed that where there is no such market or field price of crude mineral product, there shall be used in lieu thereof the market price of the product sold minus all costs of converting and transportation. This would give substantially the same interpretation to the phrase "gross income from the property" as had been given to the phrase "gross value at the mine" which was used in the Revenue Act of 1913.

Sections 2 B and 2 C (b) of the 1913 Act provided for depletion of ores and all other natural deposits, "not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made".

This is made clear by Art. 142 of Regulations 33, as follows:

> "The term 'gross value at the mine' as used in paragraphs B and C of section 2 of the Act of October 3, 1913, prescribing a limit to the amount which may be deducted in the return of individuals and corporations as depreciation in the case of mines, is held to mean the market value of ore, coal, crude oil, and gas at the mine or well, where such value is established by actual sales at the mine or well; and in case the market value of the product of the mine or well is established at some place other than at the mine or well, or on the basis of the bullion or metallic value of the ore, then the gross value at the mine is held to be the value of the ore, coal, oil, or gas sold, or of the metal produced, less transportation, reduction, and smelting charges."

This is further clarified by T. D. 2137 as follows:

> "'Gross value at the mine,' as contemplated in that provision of the Federal income tax law which authorized mining companies to deduct from gross income an amount to take care of depletion of natural deposits, is held to mean the gross price at which the product could be sold at the mine, that is, its actual bona fide market value.
>
> The term 'gross' as applied to 'value' contem-

plates the aggregate value of the product at the mine determined upon the basis of the market conditions at the time and place, and is best defined as the price at which the product sells or would sell when delivered at the mouth of the mine in a marketable condition."

We respectfully submit that the interpretation thus given to the phrase "gross value at the mine" in the 1913 Act is not that which should be given to the expression "gross income from the property" in the 1932 Act, for the following reasons, among others.

I

The Language Used in the Two Acts Is Entirely Different:

There is every reason to believe that Congress intended the words "gross income from the property" to convey a meaning different from that of the words "gross value at the mine". We submit that if Congress has intended that the provision of the 1932 Act should in this particular carry the same meaning as the 1913 Act, it would have used the same perfectly clear expression to convey that meaning. Instead, it used a quite different wording, obviously intended to convey a different meaning. So whatever meaning we may ascribe to the expression "gross income from the property" we should not ascribe to it the meaning of "gross value at the mine". It certainly means and was intended to mean something different from this.

II

THE LEGISLATIVE HISTORY OF THE 1932 ACT MAKES IT CLEAR THAT CONGRESS USED THE PHRASE "GROSS INCOME FROM THE PROPERTY" TO MEAN "GROSS RECEIPTS":

We are not left to conjecture as to this meaning for it is quite clearly set forth in the history of the legislation. The allowance for depletion of mines based on a percentage of the "gross income from the property" is the enactment into law of a proposal presented by the American Mining Congress to the Committee on Ways and Means in 1927.

Subsequent to this proposal, Mr. L. H. Parker, Chief of Staff of the Joint Congressional Committee, submitted to the Committee a "Preliminary Report on Depletion" dated September 27, 1929. There was included in the Parker Report a "Summary Report on Depletion of Metal Mines" by Mr. Alexander B. Shepherd, Mining Engineer for the Joint Committee. An interesting feature of this report is the "Summary of the results of the study of percentage depletion" which shows that the depletion allowances of metal mines for a five year period (1922-1926) under Revenue Acts then in force had amounted to approximately 17.12% of the "gross sales (equivalent to the gross income from the property)".

The provision for percentage depletion as finally enacted in 1932 was extended to coal mines and sulphur as well as metal mines, but the essential provision as to a percentage of the "gross income from the property" is the same.

The inclusion of this provision in the Revenue Act of 1932 resulted from an amendment proposed by Senator Thomas of Idaho, which provided that the allowance for depletion of metal mines should be "15 per cent * * * of the gross income from the property during the taxable year". Regardless of the subsequent changes which were made in this amendment as originally proposed, the expression "gross income from the property" remained unchanged.

When the Thomas amendment was pending before the Senate Finance Committee, Mr. Donald A. Callahan appeared before the Committee in support of that amendment. His statement and accompanying brief appear in the record of "Hearings before The Committee on Finance United States Senate Seventy-second Congress First Session on H. R. 10236" (Revenue Act of 1932), page 224.

Mr. Callahan in his discussion, and the members of the Committee in their questions, made definite references to the above-mentioned "Parker Report". In his argument Mr. Callahan refers (pages 225-226) to the fact that the proposed 15 per cent of gross income was based on the showing in that report, above referred to, that the average of depletion allowed (years 1922 to 1926) had amounted to more than 17% of the *gross receipts*. See for instance on page 226 the following colloquy:

> "Mr. Callahan. * * * * The figures that have been compiled by the Joint Committee on Internal Revenue Taxation, and which are contained in the preliminary report that was presented, covers those

very figures. It covers them not for one year but over a period of years. In which it is shown that the average of depletion allowed amounted to better than 17 per cent.

Senator Reed: On gross?

Mr. Callahan. Yes. Those figures are in this preliminary report which was prepared by Mr. Parker and his staff.

Senator Reed. Have you a copy of that report here, Mr. Parker?

Mr. Parker. Yes.

Senator Reed. The hearings before the Joint Committee?

Mr. Callahan. That is page 67.

Senator Reed. Gives only percentage of net.

Mr. Callahan. This is the gross receipts. That is for the period 1922 to 1926.

The Chairman. Well, that does not cover all classes of mining does it?

Mr. Callahan. They are all broken down. Allowance for lead and zinc ores, 17.21; iron ores, 17.74; for copper 17.21; for gold and silver 16.94; and the weighted average was 17.127."

This report was repeatedly referred to in the discussion and in the brief of Mr. Callahan as presenting the method of depletion which the Thomas amendment proposed, as represented by its provision for 15 per cent of the gross income from the property.

This report is also referred to in the brief submitted

by the National Coal Association, which appears on page 236 of this record of Hearings before the Committee on Finance, urging an allowance of "5 per cent of gross income" for coal. A table presented in that brief (page 241) shows this "5 per cent of gross income" as representing 5 per cent of "Selling price (gross income)". This use of the selling price of the product to represent what the amendment refers to as "gross income from the property" is entirely in harmony with the explanation given in the "Parker Report" regarding the intended meaning of the term "gross income from the property".

A review of this record of Hearings before the Committee on Finance makes it clear that the Committee understood that the proposal for a depletion allowance for metal mines of 15 per cent of the "gross income from the property" which was finally enacted as Section 114(b)(4) of the Revenue Act, was the same proposal as that presented in the Parker Preliminary Report on Depletion thus referred to.

A review of that report shows conclusively that a depletion allowance for metal mines of "15 per centum of the gross income from the property" was and was intended to be a *new* method and not merely the adoption of a changed percentage to the old method which had been prescribed by the 1913 Act.

(a) The Chairman's letter of transmittal of this report to the members of the Joint Committee on Internal Revenue Taxation, dated September 19, 1929, stated in part as follows:

> "This preliminary report suggests two new methods for the determination of depletion allow-

ances in the case of mines. It is requested that these methods receive your careful consideration.

Your comments and suggestions on this subject will be appreciated."

(b) The Report itself, which was signed by L. H. Parker, Chief of Staff, states (page 13): *

"(b) Percentage of gross income method.—The second method proposed for consideration is a form of percentage depletion and was proposed in a brief submitted to the Ways and Means Committee when it was considering the revenue bill of 1928."

It then quotes the proposed change (including that part we have quoted above) and states—

"A report based on similar principles was submitted by Alex R. Shepherd, mining engineer for the joint committee. This report is made a part of the appendix as Exhibit XXXI.

* * * * *

The method consists in applying a rate of 15 per cent to the gross income from the property in determining depletion. The percentage is arrived at from the average of the depletion allowed on cost, March 1, 1913, or discovery value."

(c) The Shepherd report appears on pages 63 to 74. It presents on page 65 a table entitled:

"Table I.—Summary of the metal industries for a 5-year period (1922-1926) showing the gross sales

* All page references to the Parker Report are to the 1930 print.

(equivalent to the gross income from the property), and the depletion allowed (on the basis of cost, March 1, 1913, and discovery valuations) for the different metals. This tabulation represents approximately 75 per cent of the total American-owned production."

The table then sets forth for different classes of ores—in the first column, "gross receipts on basis of net smelter returns or equivalent"; in the second column, "Depletion allowed"; and in the third column, "Depletion to net smelter returns or equivalent", giving an average of 17.127 per cent.

It states (page 66) (Italics ours)—

"Table 1 shows that the metal-mining industry has received in depletion allowances an average deduction equivalent to about 17 per cent of the *gross value.*

From the study of this subject it is believed that *15 per cent of gross sales value* with a 50 per cent limitation to net income, would be a reasonable rate to allow the metal-mining industry for the future. This reduction by 2 per cent of the actual figures shown in the summary is thought advisable to offset the continuing effect of the percentage depletion method.

The *15 per cent depletion allowance on gross sales* is equivalent to a theoretical deduction of 30 per cent on net income. In actual operations the 30 per cent on net may vary 15 per cent above or below this figure, depending on the profits made by the particular operation.

Statistics of the Internal Revenue Department covering all metal mining for the year 1925 show *depletion allowances to gross sales of 16.7* and 33 per cent to net income. From these figures and others in individual cases, it is thought probable that over a period of years (good and bad in the business sense), the greater part of the revenue to the Treasury Department will be derived from the operations showing profits above this *15 per cent average to gross sales.* Those falling below automatically are limited to 50 per cent of the net income.

The percentage plan fixes a limit to depletion allowances at both ends of the line. Taxpayers whose profits are small are justly treated by the 50 per cent limitation to net income. Taxpayers whose profits are large are limited to *15 per cent of their gross sales* which in many cases is less than the amount that they have gotten in the past. Further, the percentage basis follows the *sales price* which is just and the taxpayers will receive a more equitable depletion distribution of their wasting assets from year to year and in proportion to their income."

It states (page 68)—

"It will be necessary to define what is meant by gross income from the property and to definitely indicate the point in accounting at which it is to be determined as well as other details. This can be done, either in the act, or interpreted in the regulations.

> The consensus of opinion seems to be that the act should be written as simply as possible (as in the case of oil and gas) and the necessary definitions should be written into the regulations."

It then gives the suggestion for the wording to be used in the Act, including provision—

> "(2) In the case of metal mines the allowance for depletion shall be 15 per cent of gross income from the property during the taxable year, such allowance shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

(d) Tabulations then follow which give examples of this computation, as follows:

> Lead—Based on market price of lead per pound.
>
> Zinc Concentrates—Based on gross sales price per pound at mill.
>
> Iron Ore—Based on gross sales price f.o.b. cars at mine.
>
> Copper—Based on market price per pound of Copper.

Clearly, then, the Shepherd Report did not contemplate that the expression "gross income from the property" would carry the same meaning as that which had been given to the expression of the 1913 Act—"gross value at the mine". The proposal which he presents

is for including in the law an allowance for "15 per cent of gross income from the property" with the 15% derived from "gross sales".

The question now before the Commissioner in drafting his regulations is not one of whether Congress acted wisely when it included in Section 114 (b) (4) this provision for percentage depletion based on "gross income from the property", nor is the question now before him one as to whether the expression used was the best which might have been used to express the intent of Congress. The Commissioner is solely concerned with having his regulations express and be in harmony with what Congress intended.

We understand that there is some thought within the Bureau that because in the case of oil and gas wells, Art. 221 (i) of Treasury Regulations 74 (and similar provisions of prior regulations) provided "gross income shall be assumed to be equivalent to the market or field price of the oil and gas before conversion or transportation", i.e., price at the mouth of the well, this expression when used as applicable to mines should be similarly interpreted to mean the value of the ore at the mouth of the mine. The Joint Committee's report evidences that this was not the intention, but it was rather intended to use the market price applicable to the product in the form in which it was customarily sold.

For oil there is a generally recognized price at the mouth of the well; for iron ore there is a price for the ore f.o.b. cars, and it was intended to use such prices for these products. In the case of metals, such as copper and lead, which are ordinarily sold in refined form, it was intended to use such metal prices and not to figure

back to get an assumed value of the ore at the mouth of the mine. In each case the ordinary trade practice was the governing factor. It was for this reason that the smaller 15% was used in the case of metal mines, while 27½% remains in the case of oil and gas. Therefore, the smaller percentage used in the case of metals is ample justification, if any were needed, for the Bureau's following in its regulations the clear legislative intent as shown by the hearings before the Senate Finance Committee, and in using, in the case of metal mines, as a basis, the actual sales receipts for the metals. This gives the desired simplicity in the computations which is not obtained by using some arbitrary cut-off point not in accord with the customary trade practice.

These differences as to the various metals or mineral products were all taken into account in determining the percentage which should be applied. The 17% shown by the Joint Committee's report and referred to in the Finance Committee Hearings, was not based on using the value at the mouth of the mine for all ores. Had this been done a much higher percentage would have resulted for lead, copper, gold and silver, so we would not have had the average for all of these of approximately 17%, which was the basis for the 15% figure adopted in the law. For these metals, "gross income from the property" is taken as representing customary sales in refined metal form and on this basis the figure of approximately 17% resulted. To ignore this fact would be a gross discrimination against the miners of such metals and would not accord with the intent of Congress in adopting a uniform percentage based on their respective trade practices.

Question is raised as to the particular reason for using the words "from the property". Reference was made to the particular property because it was recognized that any taxpayer might own various properties in different locations and quite different in their character and results. It was intended that in such case each property should stand on its own basis and, subject to the limitations applicable to it, the 15% of gross is not to be computed on the aggregate sales from all properties combined, nor is the 50% of net to apply to the total net income from different properties. The computations are to be separately made for each of the different properties. If the 50% of the net income would be more than the 15% of gross from one property, that excess may not be applied to make up a deficiency as to another property. Moreover, the election, to the extent permitted, is to be made as to each separate property so that a taxpayer may adopt percentage depletion as to one property but may use cost or March 1, 1913 basis for another.

We therefore respectfully urge that the forthcoming Treasury Regulations give such definition of the phrase "gross income from the property" as will accord with the real intent of this provision of the law.

AMERICAN MINING CONGRESS,
(Signed) H. B. FERNALD,
Chairman, Tax Committee.

November 22, 1932.

THE AMERICAN MINING CONGRESS
Washington, D. C.

November 30, 1932.

The Honorable James H. Douglas,
Assistant Secretary of the Treasury,
Washington, D. C.

Regulations, Mine Depletion, Revenue Act of 1932

Dear Sir:

To supplement our Brief of November 23, 1932 as to the application of Percentage Depletion, particularly to answer definite questions which you asked of us, at the hearing on November 18th, we submit herewith a memorandum giving our suggestions as to the wording which we believe might appropriately be used in the forthcoming regulations to define the phrase "gross income from the property".

We also submit for your attention an extract from Col. Robert H. Montgomery's book, just published, in which he discusses the appropriate meaning of this phrase, and arrives at the same conclusions as we have been urging upon you.

Respectfully,

THE AMERICAN MINING CONGRESS.
By (Sgd) A. W. DICKINSON.

Memorandum as to the Definition of the Phrase "Gross Income from the Property" As Used in Section 114 (b) (4) of the Revenue Act of 1932

The memorandum of the American Mining Congress of November 22, 1932, sets forth the essential intent that "gross income from the property" meant "gross sales" and did not mean "value of the ore at the mine".

That memorandum brings out that the 15 per cent was adopted as a round figure somewhat less than the average percentages of prior depletion allowances to the gross sales and that these averages had been determined by taking for various divisions of the industry the bases on which the sales were ordinarily and customarily made in each separate division. For example, copper, lead, gold and silver were computed on refined metal prices, whereas iron ore, coal, etc. were computed on the basis of the usual sales price of the ore or coal.

Granting, as we believe it must be granted, that the law intended that the specified percentage should be applied to "gross sales", question is raised as to the appropriate wording of the regulations to express this intent. There are two possible bases, either of which would meet the test of a percentage based on "gross sales", viz.—

(a) Each taxpayer should make its computation of 15 per cent on its own actual sales of its products (whether ore, concentrates, refined metals, etc., depending on the form in which it actually made sale of its production) or

(b) For each division of the industry the 15 per

cent should be computed on the price of the product which was ordinarily and customarily the subject of sale by that particular division of the industry.

The effect of these two bases may be illustrated as follows:

(a) On the basis of actual receipts of each taxpayer, one copper mining company, for example, would figure the 15 per cent on refined metal price if it sold its product as refined metals, whereas another company would have to figure the percentage on its concentrate price if its product was sold in the form of concentrates.

(b) On the basis of the form in which the product was ordinarily and customarily sold, each copper mining company would figure the 15 per cent on the refined metal price regardless of whether it sold its product as concentrates or as refined metal, whereas an iron ore company would take its price for the ore f.o.b. cars and would not be permitted to figure the 15 per cent on the iron or steel produced from such ore.

Some justification may be urged for either of these bases. As to (a), the statement presented to the Finance Committee by Mr. Callahan was that the 15 per cent would apply to "gross receipts" or "gross sales". The Parker report refers to the proposal as one for "15 per cent depletion allowance on gross sales". These and other references could be cited to indicate the intention that the 15 per cent should be applied to the actual gross sales of each taxpayer.

On the other hand, the 15 per cent figure was derived from computations based on the ordinary and customary form in which the product was sold in the sev-

eral divisions of the mining industry. For copper, lead, silver and gold this basis was the refined metal, to accord with the customary method of selling the product.

In this connection we would note that, for nonferrous metals generally, the product is customarily sold on the basis of the market value of its net recoverable metals. This is true regardless of whether the product is sold in the form of ore, concentrates or blister. For example, where the mining company's product is shipped to a smelter, the smelter liquidation ordinarily makes its computation somewhat as follows:

1. It starts with the total metallic contents shown by assay of the product received at the smelter.

2. If then shows the deductions to be made for metals not to be paid for (representing smelter losses, etc.) with a resulting balance of the metals to be paid for.

3. Computation is then made of the market value of such metals and the resulting amount to be paid for the metallic contents of the ore.

4. On the other side computation is made of the charges for smelting such ore according to the contract or other basis agreed to; and any disbursements for transportation or other charges.

5. The result is then the net amount payable for the product received by the Smelter.

From this it will be seen that in any such case what is really sold and paid for is the recoverable metals in refined form taken at current market prices. Against this gross sales price the deductions for treatment charges, etc. are then made to get the net amount payable.

There are other cases in which the smelter does not purchase the metals but makes a charge for its smelting which is paid by the mining company, and then returns to the mining company the metals in kind, which metals the mining company itself or through an agent will later sell.

This matter of detailed procedure is merely mentioned to indicate that even though the mineral product is shipped from the mine in the form of ore or concentrates, it is really the recoverable metal content which is the subject of the sale and which is to be paid for. This is the recognized basis in the industry which was adopted in computing the depletion percentage for such metals.

If we adopt basis (a) and hold that the 15 per cent should be applied to the gross sales of each particular taxpayer according to the form in which that taxpayer may dispose of its product, the proposed regulation might be made to read somewhat as follows:

PROPOSAL A:

> "For the purpose of this subdivision 'the gross income from the property' shall be the competitive market receipts, or their equivalent, received from the sale of the crude, partially beneficiated, or refined metal, the product actually disposed of by the taxpayer to govern the method of computation of receipts in all cases."

Such a regulation would comply with the essential requirement that the percentage should be computed on gross sales. It would give the simplest possible manner

of making the computation. It is, however, subject to the possible objection that it might not give the same depletion basis to all the taxpayers in any particular division of the industry, but one might receive more and another less according to the particular way in which it happened to dispose of its product. Also it may be urged that such a regulation would not be in accord with the regulations as to oil which require the use of the basis on which oil production is ordinarily sold in that industry, regardless of how a particular taxpayer may dispose of its own product.

We may then suggest that basis (b) be adopted, somewhat as follows:

PROPOSAL B:

"'Gross income from the property' as used in Section 114 (b) (3) and (4) and Articles 221 to 248, inclusive, means the gross sales of the mineral product of the property in the form in which it is ordinarily and customarily sold by the owners or operators of oil or gas wells or by the owners or operators of the particular branch of the mining industry. For oil and gas, the actual sales price of the crude mineral product shall be used, or if the crude mineral product is not sold at the mine or well, then there shall be used the recognized or usual market or field prices (as of the date of sale by the taxpayer of the product which is sold) of crude mineral product of like kind at the mine or well. For coal, the price to be used shall be the actual or recognized price for sale of coal on cars

ready for shipment to purchasers. For iron ore and other metalliferous ores which are customarily sold f.o.b. cars at mine, such price shall be used. For lead, copper, gold, silver, and other metals which are customarily sold in refined form, the usual refined metal prices f.o.b. refinery shall be used."

This proposal it will be noted conforms to the basis used in the Parker report in computing the percentages. It uses a basis of gross sales or gross receipts, but for any taxpayer adopts the standard which is customarily used in his particular branch of the industry.

One reason for using the basis which is customary in the trade or business is that it would be more in harmony with what has already been prescribed for oil. The regulations have for some years prescribed for all oil and gas companies the basis of sales at the well, which is the customary basis ordinarily used in the industry. Such basis is adopted by the regulations as applicable to all such producers of oil regardless of whether or not that is the particular manner in which their sales are made. Proposal B would adopt for mines a similar basis and require that the ordinary and usual selling basis customarily applicable in each division would be used as applicable to all producers of that division, regardless of the particular form in which any producer sold its own product.

We believe either of these proposals would meet the essential intent of the law, but that Proposal B would also be in harmony with the prior provisions of the regulations regarding oil and gas.

These proposals are accordingly submitted for consideration by the Treasury Department.

THE AMERICAN MINING CONGRESS,
(Signed) H. B. FERNALD,
Chairman, Tax Committee.

November 29, 1932.

WHAT CONSTITUTES "GROSS INCOME"

(Extract from pages 458-460 "Federal Tax Handbook —Revenue Act of 1932"—Dated October 31, 1932 by Robert H. Montgomery)

It follows that the point at which the value of the production of the mine (or oil or gas well) shall be taken is of importance. For example, shall the income of an anthracite mine be the selling value of the coal after it comes from the breaker in which it is prepared for market, or shall an attempt be made to value the coal after it comes out of the shaft and before it goes into the breaker and such estimated value be deemed to be the gross income from the mine? It is seldom, if ever, that the output of an anthracite mine is sold before it has gone through the breaker. In other words, the breaker operation is, broadly speaking, a part of the mining of the coal, the work done up to the time the coal emerges from the shaft being the underground part of the operation, and the work thereafter—of which the breaker operation is the principal portion—being the above-ground part of the total mining operation. Both underground and above-ground operations are essential to the extraction of a marketable product from the mine.

Again, in the case of a copper mine, the production of the crude or raw ore is merely a first step in obtaining copper—the product for which the mining operation is carried on—from the mine. Possibly the ore may sometimes be sold and the smelting and refining of it be done by or for the purchaser, but, if so, it is the exception and not the rule. The smelting and refining operations are most often carried on by or for the miner of the ore. These operations are essentially for the purpose of removing the impurities which are intermingled with the copper, and not to produce something other than the only thing which gives value to the mine—its copper content. The purpose or result of the smelting and refining operations is not to put the copper into fabricated form.

Hence, it may well be claimed that the gross income of the mine should be based on the sales value of what would normally be considered to be the product of the mine, whether prepared coal, refined copper, or other mineral. The question has many angles and will require careful consideration in each case in which percentage depletion is claimed. It may not be feasible to lay down a general rule which will apply without exception or modification to all classes of mines, as well as to oil and gas wells.

Depletion has always been determined in the past on the basis of values of metal mines based upon the price at which the metallic contents (concentrated, smelted and refined) were sold in the market.

The basis on which Congress fixed the rate of 15 per cent as applied to metal mines was based upon statistics furnished to it by the engineers of the Treasury Depart-

ment, showing the average rate of depletion allowed metal mines, computed on valuations made in this way. Unquestionably, Congress in fixing the rate of percentage depletion relied upon these statistics and intended that the metal mines should have an allowance which more or less approximated the old amounts computed on the values of the mine, arrived at by reference to the sale of the finished product.

Mines, particularly copper mines, are not bought, sold, or valued in the market except by reference to the price of the finished product. The price of the finished product is always looked upon as the gross income, and the determination of this gross annual income is the first step in valuing such properties. This has been the universal practice among engineers and investors in mines.

Valuation of mines for state tax purposes (where there is not a special statute defining some arbitrary method or establishing some different formula) are regularly made by reference to price of the finished product, and the local state courts have repeatedly sustained this method.

Valuations of mines for estate tax purposes and before the courts and Board of Tax Appeals, where the value has become material for other purposes than depletion, are regularly valued by reference to the price of the finished product.

There are no satisfactory and reliable statistics published or issued by the metal mining industry, particularly the copper industry, giving or furnishing the price of the ore at the collar of the shaft. There is no source from which such statistics could be obtained or as-

sembled because there is generally no regular market. Therefore, the gross income from the property from ore at the collar of the shaft can only be *computed* by a series of calculations or deductions starting from the price of the finished product and deducting from it the cost of beneficiation (refinement, smelting, concentrating, operating, etc.) plus a reasonable profit on the investment in such operations. This would lead to all sorts of troublesome and difficult questions of accounting and to the indeterminable question of deciding what is a fair profit in each one of these operations.

Undoubtedly, Congress's intention in passing percentage depletion was to simplify and not render more complex the computation of depletion.

Hence, it may well be claimed that the gross income of the mine should be based on the sales value of what would normally be considered to be the product of the mine, whether prepared coal, refined copper, or other mineral. The question has many angles and will require careful consideration in each case in which percentage depletion is claimed. It may not be feasible to lay down a general rule which will apply without exception or modification to all classes of mines, as well as to oil and gas wells.

December 7, 1932.

The Honorable James H. Douglas,
Assistant Secretary of the Treasury,
Washington, D. C.

My dear Mr. Douglas:

In the memorandum as to the definition of the phrase "gross income from the property", dated November 29th, 1932 and filed November 30th by our Tax Committee, we submitted two proposals relative to Article 221, paragraph (g) of the proposed regulations for the Revenue Act of 1932.

In proposal "A" we omitted the word "minerals" which would cover percentage depletion as shown in the Revenue Act of 1932 for coal, oil, gas and sulphur. We therefore request that "A" be amended to read as follows:

> "PROPOSAL A: For the purpose of this subdivision 'the gross income from the property' shall be the competitive market receipts, or their equivalent, received from the sale of the crude, partially beneficiated, or refined metal or *minerals:* the product actually disposed of by the taxpayer to govern the method of computation of receipts in all cases."

In proposal "B" we also omitted specific reference to sulphur which is allowed percentage depletion under the Revenue Act of 1932, and we therefore ask to have this proposal read as follows:

> "PROPOSAL B: 'Gross income from the property' as used in Section 114 (b) (3) and (4) and

articles 221 to 248, inclusive, means the gross sales of the mineral product of the property in the form in which it is ordinarily and customarily sold by the owners or operators of the particular branch of the mining industry. For oil and gas, the actual sales price of the crude mineral product shall be used, or if the crude mineral product is not sold at the well, then there shall be used the recognized or usual market or field prices (as of the date of sale by the taxpayer of the product which is sold) of crude mineral product of like kind at the well. For *sulphur and* coal, the price to be used shall be the actual or recognized price for sale of *sulphur or* coal on cars ready for shipment to purchasers .... For iron ore and other metalliferous ores which are customarily sold f.o.b. cars at mine, such price shall be used. For lead, copper, gold, silver and other metals which are customarily sold in refined form, the usual refined metal prices f.o.b. refinery shall be used."

In considering our memorandum on this subject, we respectfully request that these proposals be used as above corrected.

Faithfully yours,

A. W. DICKINSON.

Internal Revenue Service, Revenue Ruling 54-109

(1954-1 CUM. BULL. 62)

SECTION 23(m).—DEDUCTIONS FROM GROSS INCOME: DEPLETION

Rev. Rul. 54-109

REGULATION 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

(Also Section 114, Section 39.114-1.)

Determination of the processes properly included in the term "ordinary treatment processes" as set forth in section 39.23(m)-1(f)(3) of Regulations 118, and section 114(b)(4)(B) of the Internal Revenue Code, with respect to the manufacture of brick and tile from shale and brick and tile clay.

Advice has been requested as to the processes in the manufacture of brick and tile and kindred products from shale and brick and tile clay that are included under the term "ordinary treatment processes" as used in section 39.23(m)-1(f) of Regulations 118, and section 114(b)(4)(B) of the Internal Revenue Code.

The various treatment processes involved in the manufacture of such products are as follows:

(1) The mineral is first extracted from the earth, usually from open pits.

(2) It is transported to the plant, generally by dumpcars or trucks.

(3) The mineral is there dumped into bins or

sheds for storage or directly into a crusher or granulator where the large chunks are reduced to small workable sizes.

(4) In some cases, secondary grinding is required.

(5) The mineral is then conveyed to a pugmill where it is mixed to the proper consistency usually with the addition of water and/or other materials.

(6) The mixed product is then formed into the shape desired, usually by an extrusion or molding machine.

(7) These raw forms are then processed for the removal of excessive moisture and are then burned in kilns.

(8) Finally, the finished products are drawn from the kiln and loaded for shipment or storage.

Based on these facts, the first four processes are "ordinary treatment processes" within the meaning of section 114(b)(4)(B) of the Code, and section 39.23(m)-1(f) of Regulations 118. The mixing of the mineral in the pugmill with water where this is done to separate out sand or other materials from the clay or shale is also considered to be an "ordinary treatment process"; other actions in the pugmill, as well as the succeeding processes listed above, are not considered to be "ordinary treatment processes."

As to the computation of the gross and net income from the property for percentage depletion purposes after the cost of mining and manufacturing have been segregated, see sections 29.23(m)-1 (f) and (g) of Regulations 111, and sections 39.23(m)-1 (e) and (g) of Regulations 118.

Letter of June 4, 1955, from Senator Walter F. George to T. Coleman Andrews, Commissioner of Internal Revenue [2]

June 4, 1955.

Honorable T. Coleman Andrews, Commissioner,
Internal Revenue Service,
Washington, D. C.

DEAR COMMISSIONER ANDREWS:

It was very considerate of you to meet the representatives of the Cherokee Brick and Tile Company and parties interested in the regulation for computing depletion allowance for federal income and excess profits tax purposes on brick clay.

I had, of course, expected to be present at the conference and desired to do so, but an unforeseen situation arose in the Foreign Relations Committee which made it absolutely necessary for me to remain with the Committee during the hours of your conference in my office. I have learned through my Secretary, Mr. John Carlton, that you with some of your assistants appeared and that you went into the matter at some length.

You will recall that, at the first or primary meeting with the Joint Committee on Internal Revenue Taxation, I stated my position and my position is precisely the same as it was at that time, namely, the statute defining mining for purposes of computing depletion allowance for federal income and excess profits tax pur-

[2] This letter is referred to and quoted in the House Hearings, 1959, pp. 258, 264 and was reproduced in full, with Senator George's approval in the Brick and Clay Record, Vol. 130, No. 1 (January, 1957), pp. 87-88.

poses does not exclude manufacturing processes so long as they are ordinary processes normally and necessarily used in obtaining commercially marketable mineral products.

I personally recall the discussion in executive session between members of the Senate Finance Committee when this statute was under consideration. At the time it was not only understood but I pointed out what I knew and believed to be the facts about brick manufacture. I stated that often lands, containing brick clay deposits, could be bought at a cheap price but generally the recovery of the clay from the areas where it existed in Georgia, at least, was a costly operation. I specifically said to the members of the Committee, who were present, that clay had no commercial marketable value, as a general rule, until after the clay was given the ordinary treatment processes. In the meeting with the Joint Committee on Internal Revenue Taxation, my recollection is that the position taken by the Commissioner was that clay would have some commercially marketable value before baking or cooking. But one instance, however, was pointed out and it was clearly an exception to the general rule. Brick clay at this time has no commercial value until it is baked or cooked. The Senate Finance Committee certainly understood this clearly before the Act, giving depletion allowance to brick clay, was passed.

There is nothing ambiguous about the language "commercially, marketable, mineral product". It is plain and certain. Today raw clay has no commercial value for brick and tile manufacture except in some isolated cases where the clay is desired for other pur-

poses. Clay cannot be reasonably regarded as an ore and it does not fall within the exceptions to the general rule, stated above, and recognized in the Cherokee Brick and Tile Company Case against the United States, U.S. District Court for the Middle District of Georgia.

The intent of Congress in this matter is too clear to admit of argument.

If it is the view of the Commissioner that the Congress went too far in stating the rule for computing depletion allowance for federal income and excess profits tax purposes, as interpreted by the courts, then I most respectfully suggest that the Commissioner or the Secretary of the Treasury should come before the proper Committee of the Congress and urge an amendment to the law itself. The expense of burdensome litigation ought not to be thrown upon the taxpayers in this instance, taxpayers who as a general rule are unable to protect their rights through expensive litigation in the courts.

Sincerely yours,

WALTER F. GEORGE.

Internal Revenue Service, Technical Information Release No. 62, October 18, 1957.

(1957 INT. REV. BULL. No. 43, at 51; 5 CCH 1957 STAND. FED. TAX REP. ¶ 6824; 4 P-H 1957 FED. TAX SERV. ¶ 76,726.)

The Internal Revenue Service announced that in view of the denial by the Supreme Court of the United States on October 14, 1957, of the Government's peti-

tions for certiorari in United States v. Merry Brothers Brick & Tile Co., et al., 242 Fed. (2d) 708 (1957), and in Dragon Cement Co., Inc. v. United States, 244 Fed. (2d) 513 (1957), it is taking steps to dispose of pending litigation and claims involving brick and tile clay and cement rock, as required under these decisions, and to conform Treasury regulations and outstanding rulings accordingly. This should permit the expeditious disposition of the great majority of such cases. Consideration is being given as to the applicability of these decisions in cases involving fire clay and limestone.

Taggart, Handbook of Mineral Dressing (1945 ed.)

[2-70] 19. GOLD AND SILVER

Gold

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[2-71] TREATMENT

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[2-73] Separation methods applicable to gold and gold-silver ores are amalgamation (Sec. 14, Arts. 5 to 8); gravity concentration, particularly sluicing, straking, fine jigging, and tabling (Sec. 11); flotation (Sec. 12, Art. 49), cyanidation, and smelting. Silver, when it occurs [2-74] other than as a minor associate of gold, is usually so closely associated with copper or lead minerals that it remains locked with them in ordinary grinding, or goes with them, even if freed, when subjected to ordinary methods of concentration, so that separation is deferred to smelting treatment.

The primary desideratum in precious-metal separations is recovery in metallic form at the mill, since this both reduces freight and separation costs (by eliminating shipment to a smelter and smelter charges), and, by making cash returns quickly available, decreases the amount of working capital necessary. Amalgamation and cyanidation both yield bullion at the mill. Hence one or both of these methods is normally practiced, if the ore is amenable. Nonamenability may flow from minuteness of size of the precious-metal particles, or from association with minerals which interfere with the working of the processes. In either case concentration is utilized as a means of reducing bulk to an extent that makes more intense treatment by amalgamation or cyanidation economically possible, or to get the values into the best shape for final separation by smelting. Costs of ultimate separation increase from simple amalgamation to flotation with smelting of concentrate; the following list comprises an arrangement of treatment methods and combinations thereof in general order of increasing total charges against the gold, which embraces most flow sheets.

—1. **Amalgamation only.** Applicable to clean primary ores, and to fully oxidized surface ores of gold in which the gold particles are not too fine to settle in a shallow flowing stream of water, and are not rusty. Plants using amalgamation only are those which serve small mines, usually in the prospecting stage, extracting high-grade ore. Typical examples are reported from northeastern Oregon (*IC 7015*).

At the GLEASON MINE a highly oxidized quartz ore is fed directly into a battery of 5 @ 650-lb. stamps,

crushed through a 45-m. screen, and passed over an amalgamating plate sending tailing to waste. A recovery of 90% from $40 ore is reported. The power plant consists of a 12-hp. steam engine and a 14-hp. wood-burning boiler. See also Fig. 78.

2. **Gravity concentration + amalgamation.** Applicable to ores in which gold is relatively coarse, but either coated, or associated with sulphides not harmful to amalgamation, or ores in which the amount of gold is very small (placers). In any case the initial recovery is made by concentration, and concentrate is amalgamated, either in the concentrator (*e.g.*, mercury in sluice riffles), or in a barrel or the like, with more or less regrinding, if necessary to render the particles amenable to mercury wetting and collection.

This is the typical treatment scheme for placers (Art. 20), for small mills to treat high-grade lode ores in the development stage, and, at a few plants, for the final mill for such ores. For many years it was the only type of mill used for ores such as those on the Mother Lode in California (see *IC 6476*, ARGONAUT MILL). For recent Mother Lode practices see IDAHO-MARYLAND (Fig. 64) and also p. 99.

At MONT TSI, Belgian Congo, ore is ground in a Chilean mill with mercury, passes through an amalgam trap, thence over blanket tables, is thickened, ground in a ball mill-classifier circuit with Hg, passes through an amalgam trap, and thence over blankets which make final tailing. All concentrates are barrel-amalgamated.

3. **Amalgamation ± gravity concentration + cyanidation.** Applicable to clean ores containing gold of a

wide range of sizes, a part too fine for amalgamation and a part too coarse for rapid solution by cyanide.

4. **Cyanidation only.** Applicable to clean ores with gold finely dispersed, sulphide content relatively low, and at least an appreciable part of the gold in the nonsulphide mineral. See *Rose and Newman; Dorr.*

5. **Cyanidation ± concentration + cyanidation of concentrate.** Used with clean ores containing a relatively small amount of pyrite in which the gold is extremely fine. The ore is usually ground in cyanide solution, a sand-slime separation made, pyrite floated from the sand, concentrate reground (usually in cyanide) to expose the gold, and the reground material further cyanided separately or mixed back with the original slime.

6. **Flotation (± gravity concentration and or amalgamation) + cyanidation of concentrate.** For clean ores with relatively high pyrite content, low content of valuable base metals (Pb, Zn, Cu), and gold largely associated with the sulphides. If coarse gold is present, amalgamation or gravity concentration with amalgamation of concentrate is inserted in the grinding circuit.

7. **Flotation + cyanidation of tailing.** Used for ores in which important amounts of gold are present in the nonsulphide minerals, and the sulphides are independently valuable or contain minerals harmful to cyanidation. Sulphide concentrate may either be smelted or treated (*e.g.*, roasting of arsenical concentrate) to render it amenable to cyanidation.

8. **Flotation ± gravity concentration and or amalga-**

mation. Used for ores in which the gold is associated with sulphides and may not be separated from them other than by smelting, either for economic reasons (sulphides valuable and precious metals recovered from them as an incident to smelting), or for technical reasons (removal of cyanicides too costly; gold too fine, etc.). Use or non-use of gravity concentration depends upon the size at which sulphides free, and use of amalgamation is dependent upon size of gold, its surface character with and without grinding, the nature of the sulphide associates, and the quantity of gold thus recoverable.

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[3-13] 9. CLAY

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[3-14] **Treatment.** COMMON CLAYS, such as are used for heavy-clay products, and most fire clays, will not stand the cost of beneficiation beyond the limits of selective mining, thorough mixing (and blending, if necessary), plus, possibly, crushing or screening out pebbles. Shales are crushed, pulverized, screened, and either PUGGED (wet-ground or TEMPERED) [3-15] for soft- or stiff-mud products, or they are dry-ground and dampened for semi-dry press products. BRICKS may be molded by hand, but mechanical methods are almost universal. Soft-mud bricks are wiped or pressed wet into individual molds. In the stiff-mud process, the clay paste is forced through a die as a ribbon which can be cut transversely into brick sizes, usually by a wire. Green brick rough-shaped by either process may be re-

pressed to exact dimensions, usually after partial drying. Dry-pressing is used mainly for floor and wall tile but has been adopted by many firebrick makers and is gaining ground in other branches of the ceramic industry. Although brick may be dried in the open air, modern clay-products plants have artificial driers, usually of the car-tunnel type. Various kilns may be employed for burning products; common brick may even be piled up to form their own kiln (SCOVE KILN), arched spaces being left at the bottom for the fire and the outer courses being laid close and sealed with mud to retain heat. For soft common brick, the minimum firing temperature is close to 900° C., the average for ordinary brick being perhaps 1,050°; for vitrified brick the temperature is higher and heating must be continued longer. Fire-clay brick are burned at 1,250 to 1,400° C., and a few special products require up to 1,640° C.

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Part E; Chart of Cases Applying the Commercially Marketable Products Rule

Case Name and Citation	Court and Date	Disposition on Appeal, Date	Products Claimed by U. S. as Base for Depletion	Products Claimed by Taxpayer as Base for Depletion	Products Finally Allowed as Base for Depletion
New Idria Quicksilver Mining Co. v. Commissioner, 2 T. C. 412	Tax Court, July 14, 1943 (Smith, J.)	Rev'd, 144 F. 2d. 918, 9th Cir., Sept. 22, 1944. (Garrecht, J., op., Mathews, J., Stephens, J.)	cinnabar ore	mercury, flasked	mercury, flasked
International Talc Co. v. Commissioner, 15 T. C. 981	Tax Court, Dec. 29, 1950 (Van Fossan, J.)		crude talc, as mined	pulverized talc in bags	pulverized talc in bags
The Black Mountain Corp. v. Commissioner, 21 T. C. 746	Tax Court, Feb. 25, 1954 (Opper, J.,) (reviewed by Court)		coal, cleaned, broken, sized, and loaded for shipment	coal, cleaned, broken, sized, loaded for shipment, and, for a portion of the coal, oil treated (to allay dust)	coal, cleaned, broken, sized, and loaded for shipment
Cherokee Brick & Tile Co. v. United States, 122 F. Supp. 59	M. D. Ga., June 4, 1954 (Davis, C. J.)	Aff'd, 218 F. 2d. 424, 5th Cir., Jan. 21, 1955 (Holmes, J., op., Borah, J.)	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
The Hitchcock Corp. v. Townsend, 132 F. Supp. 785	M. D. N. C. July 15, 1955 (Hayes, J.)	Aff'd, 232 F. 2d. 444, 4th Cir., Apr. 9, 1956 (Parker, C. J., Soper, J., Dobie, J., op.)	crude talc, as mined	pulverized talc in bags and talc crayons, packaged	pulverized talc in bags and talc crayons, packaged
Haviland Clay Works Co. v. United States, 169 F. Supp. 61	N. D. Ohio Dec. 13, 1955 (Kloeb, J.)		ground brick and tile clay before entering the pug mill	tile	tile
Ferris Brick Co. v. United States, 51 A.F.T.R. 1116	N. D. Tex., Jan. 2, 1956 (Atwell, J.)		ground brick and tile clay before entering the pug mill	brick	brick

Case Name and Citation	Court and Date	Disposition on Appeal, Date	Products Claimed by U. S. as Base for Depletion	Products Claimed by Taxpayer as Base for Depletion	Products Finally Allowed as Base for Depletion
Cherokee Brick & Tile Co. v. United States, Civil No. 1251	M. D. Ga., Feb. 27, 1956 (Davis, C. J.)		ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Sapulpa Brick & Tile Corp. v. United States, 51 A.F.T.R. 1665	N. D. Okla., May 8, 1956 (Savage, J.)	Aff'd, 239 F. 2d. 694, 10th Cir., Dec. 20, 1956 (Phillips, J., op., Lewis, J., Murrah, J.)	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Reliance Clay Products Co. v. United States, 51 A.F.T.R. 1649	N. D. Tex., May 12, 1956 (Atwell, J.)	Aff'd, 242 F. 2d. 708, 5th Cir., Mar. 27, 1957 (Hutcheson, C. J., op., Rives, J., Brown, J.); cert. denied, 355 U. S. 824, Oct. 14, 1957	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Merry Bros. Brick & Tile Co. v. United States, 145 F. Supp. 186	S. D. Ga., July 3, 1956 (Scarlett, J.)	Aff'd, 242 F. 2d. 708, 5th Cir., Mar. 27, 1957 (Hutcheson, C. J., op., Rives, J., Brown, J.); cert. denied, 355 U. S. 824, Oct. 14, 1957	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Dragon Cement Co. v. United States, 144 F. Supp. 188	S. D. Me., Aug. 24, 1956 (Aldrich, J.)	Rev'd, 244 F. 2d. 513, 1st Cir., May 14, 1957 (Magruder, C. J., op., Woodbury, J., Hartigan, J.); cert. denied, 355 U. S. 833, Oct. 14, 1957	pulverized cement rock prior to burning in the kiln	cement	cement [1]

[1] On remand, 163 F. Supp. 168 (S. D. Me., June 24, 1958) the only remaining issue was the inclusion of bagging costs in the depletion base. The court reso this question in favor of the taxpayer.

Case Name and Citation	Court and Date	Disposition on Appeal, Date	Products Claimed by U. S. as Base for Depletion	Products Claimed by Taxpayer as Base for Depletion	Products Finally Allowed as Base for Depletion
Estate of L. L. Stephenson v. United States, 51 A.F.T.R. 1692	N. D. Ala., Sept. 26, 1956 (Lynne, J.)	Aff'd by stip., 52 A.F.T.R. 1781, 5th Cir., Apr. 25, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Tupelo Brick & Tile Co. v. United States, 51 A.F.T.R. 1717	N. D. Miss., Oct. 5, 1956 (Cox, J.)	Aff'd by stip., 52 A.F.T.R. 1817, 5th Cir., Apr. 25, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Chattahoochee Brick Co. v. Cobb, 51 A.F.T.R. 1388	N. D. Ga., Oct. 30, 1956 (Sloan, J.)	Aff'd by stip., 52 A.F.T.R. 1297, 5th Cir., Apr. 25, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Atlanta Brick & Tile Co. v. United States, 51 A.F.T.R. 1345	N. D. Ga., Oct. 30, 1956 (Sloan, J.)	Aff'd by stip., 52 A.F.T.R. 1214, 5th Cir., Apr. 25, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Kirby v. Campbell, 51 A.F.T.R. 1542	N. D. Tex., Nov. 7, 1956 (Atwell, J.)	Aff'd by stip., 52 A.F.T.R. 1513, 5th Cir., Apr. 25, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground brick and tile clay before entering the pug mill	brick	brick
Elgin-Butler Brick Co. v. United States, 146 F. Supp. 378	W. D. Tex., Nov. 14, 1956 (Rice, J.)	Aff'd by stip., 52 A.F.T.R. 1350, 5th Cir., Apr. 25, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground fire clay before entering the pug mill	structural brick and tile, fire brick, and negligible amount of raw clay and ground clay in bags sold in such forms	structural brick and tile, fire brick, and negligible amount of raw clay and ground clay in bags sold in such forms

Case Name and Citation	Court and Date	Disposition on Appeal, Date	Products Claimed by U. S. as Base for Depletion	Products Claimed by Taxpayer as Base for Depletion	Products Finally Allowed as Base for Depletion
Cherokee Brick & Tile Co. v. United States, Civil No. 1323	M. D. Ga., Dec. 5, 1956 (Davis, C. J.)	Aff'd by stip., No. 16,647, 5th Cir., May 3, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Teague Brick & Tile Co. v. United States, 51 A.F.T.R. 1709	W. D. Tex., Dec. 11, 1956 (Rice, J.)	Aff'd by stip., 57-2 U.S.T.C. ¶ 9745, 5th Cir., April 29, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Acme Brick Co. v. United States, 167 F. Supp. 911	N. D. Tex., Dec. 14, 1956 (Estes, J.)	Aff'd by stip., 52 A.F.T.R. 1185, 5th Cir., Apr. 25, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground fire clay and ground brick and tile clay before entering the pug mill	structural brick and tile, fire brick, and negligible amount of ground fire clay sold in such form	structural brick and tile, fire brick, and negligible amount of ground fire clay sold in such form
Harvey v. United States, 52 A.F.T.R. 1448	D. Ariz., Feb. 21, 1957 (Ling, J.)		ground brick and tile clay before entering the pug mill	brick	brick
Texas Vitrified Pipe Co. v. United States, Civil No. 3329	N. D. Tex., Feb. 12, 1957 No. 16,073 (Estes, J.)	Aff'd by stip., 5th Cir., May 10, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground shale before entering the pug mill	vitrified sewer pipe, flue lining, and related vitrified products	vitrified sewer pipe, flue lining, and related vitrified products
Louisville Brick Co. v. United States, 1 A.F.T.R. 2d 563	N. D. Miss., Apr. 17, 1957 (Cox, J.)		ground brick and tile clay before entering the pug mill	brick	brick
American Gilsonite Co. v. Commissioner, 28 T. C. 194	Tax Court, Apr. 29, 1957 (LeMire, J.)	Rev'd in part,[2] 259 F. 2d. 654, 10th Cir., Sept. 25, 1958 (Bratton, C. J., Phillips, J., op., Lewis, J.); cert. denied, 359 U. S. 925, Mar. 2, 1959	gilsonite, crushed and screened	gilsonite, crushed, screened, and, in the case of 10% of its production, pulverized, and bagged	gilsonite, crushed and screened, and in the case of 10% of its production, pulverized

[2] Tax Court reversed on including income attributable to bagging in the depletion base.

Case Name and Citation	Court and Date	Disposition on Appeal, Date	Products Claimed by U. S. as Base for Depletion	Products Claimed by Taxpayer as Base for Depletion	Products Finally Allowed as Base for Depletion
United States v. Burns Brick Co., Civil Nos. 1276, 1285, 1326, 1327	M. D. Ga., Dec. 5, 1956 (Davis, C. J.)	Aff'd by stip.: 57-2 U.S.T.C. ¶ 9746, 5th Cir., May 3, 1957; cert. denied, 355 U. S. 824, Oct. 14, 1957	ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Riverton Lime & Stone Co., Inc. v. Commissioner, 28 T. C. 446	Tax Court, May 24, 1957 (Rice, J.)		limestone, crushed, and small amount of waste screenings sold as such	hydrated hydraulic lime in bags and small amount of waste limestone screenings sold as such	hydrated hydraulic lime in bags and small amount of waste limestone screenings sold as such
Elgin Standard Brick Mfg. Co. v. United States 153 F. Supp. 279	W. D. Tex., June 12, 1957 (Rice, J.)	Aff'd by stip., 1 A.F.T.R. 2d 645, 5th Cir., Dec. 4, 1957	ground fire clay before entering the pug mill	structural brick and tile, fire brick, and negligible amount of raw and ground fire clay sold in such forms.	structural brick and tile, fire brick, and negligible amount of raw and ground fire clay sold in such forms
Strickland v. United States, 153 F. Supp. 125	E.D.N.C., July 2, 1957 (Gilliam, J.)		ground brick and tile clay before entering the pug mill	brick	brick
The Lovell Clay Products Co. v. United States, 167 F. Supp. 891	D. Wyo., July 20, 1957 (Kerr, J.)		ground brick and tile clay before entering the pug mill	brick, tile, sewer pipe	brick, tile, sewer pipe
Iowa Limestone Co. v. Commissioner, 28 T. C. 881	Tax Court, July 25, 1957 (LeMire, J.)	Aff'd, 269 F. 2d. 398, 8th Cir., July 10, 1959 (Vogel, J., Sanborn, J., Van Oosterhout, J., op.)	crushed limestone	dried and pulverized limestone	dried and pulverized limestone
Acme Brick Co. v. United States, 160 F. Supp. 604	N. D. Tex., Sept. 3, 1957 (Estes, J.)		ground brick and tile clay and ground fire clay before entering the pug mill	structural brick and tile, fire brick, and negligible amount of ground fire clay sold in such form	structural brick and tile, fire brick, and negligible amount of ground fire clay sold in such form

Case Name and Citation	Court and Date	Disposition on Appeal, Date	Products Claimed by U. S. as Base for Depletion	Products Claimed by Taxpayer as Base for Depletion	Products Finally Allowed as Base for Depletion
Uteo Products, Inc. v. United States, 32 A.F.T.R. 1823	D. Utah, Oct. 24, 1957 (Ritter, J.)	Rev'd,[3] 257 F. 2d. 65, 10th Cir., June 10, 1958 (Phillips, J., op., Bratton, J., Breitenstein, J.)	crushed and sized perlite	crushed, sized, and expanded (heated) perlite in bags	crushed, sized, and expanded (heated) perlite
Fraser Brick & Tile Co. v. United States, 32 A.F.T.R. 1391	W. D. Tex., Oct. 28, 1957 (Rice, J.)		ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Big Run Coal & Clay Co. v. United States, 1 A.F.T.R. 2d 647	W. D. Ky., Nov. 4, 1957 (Brooks, J.)		ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Murray Tile Co. v. United States, 1 A.F.T.R. 2d 646	W. D. Ky., Nov. 4, 1957 (Brooks, J.)		ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Southern Lightweight Aggregate Corp. v. United States, 1 A.F.T.R. 2d 392	E. D. Va., Dec. 23, 1957 (Hoffman, J.)		an earlier unspecified form of slate before it is processed into lightweight aggregate	lightweight aggregate made from crushed, screened, and heated slate	lightweight aggregate made from crushed, screened, and heated slate
Northwest Magnesite Co. v. United States, 1 A.F.T.R. 2d 1405	E. D. Wash., Mar. 6, 1958 (Driver, J.)		magnesite ore after concentration	dead burned magnesite (burned in a kiln), crushed and sized	dead burned magnesite (burned in a kiln), crushed and sized
Arvonia-Buckingham Slate Co. v. United States, 167 F. Supp. 903	E. D. Va., Mar. 26, 1958 (Hutcheson, C. J.)		unprocessed slate as quarried	roofing slate shingles, flagstone, rubble	roofing slate shingles, flagstone, rubble

[3] District Court reversed on including income attributable to bagging in the depletion base. This was the only issue on appeal.

Case Name and Citation	Court and Date	Disposition on Appeal, Date	Products Claimed by U. S. as Base for Depletion	Products Claimed by Taxpayer as Base for Depletion	Products Finally Allowed as Base for Depletion
Monolith Portland Cement Co. v. United States, 168 F. Supp. 692	S. D. Cal., Apr. 14, 1958 (Mathes, J.)	Modified[1] and Aff'd, 269 F. 2d. 629, 9th Cir., July 2, 1959 (Hamley, J., op., Chambers, J., Jertberg, J.)	pulverized limestone	cement	cement
Cordell v. Scofield, 1 A.F.T.R. 2d 1853	W. D. Tex., May 27, 1958 (Rice, J.)		ground brick and tile clay before entering the pug mill	brick and tile	brick and tile
Cannelton Sewer Pipe Co. v. United States, 2 A.F.T.R. 2d 5277	S. D. Ind., June 25, 1958 (Holder, J.)	Aff'd, 268 F. 2d 334, 7th Cir., June 15, 1959 (Duffy, C. J., Hastings, J., op., Knoch, J.); cert. granted, 361 U. S. 923, Dec. 14, 1959	raw fire clay and shale *or* ground fire clay and ground shale, *or* common brick	vitrified clay sewer pipe, flue lining, related vitrified products, and negligible amount of ground fire clay in bags sold in such form	vitrified clay sewer pipe, flue lining, related vitrified products, and negligible amount of ground fire clay in bags sold in such form
Elgin Standard Brick Mfg. Co. v. United States (unreported)	W. D. Tex., July 15, 1958 (Rice, J.)		ground fire clay before entering the pug mill	structural brick and tile, fire brick, and negligible amount of raw and ground fire clay sold in such forms	structural brick and tile, fire brick, and negligible amount of raw and ground fire clay sold in such forms
Riverside Cement Co. v. United States, 2 A.F.T.R. 2d 6175	S. D. Cal., Sept. 30, 1958 (Mathes, J.)		crushed limestone	cement in bulk and in bags	cement in bulk and in bags
Pacific Clay Products v. United States, 3 A.F.T.R. 2d 873	S. D. Cal., Oct. 30, 1958 (Holland, J.)	Pending, 9th Cir., No. 16,404	raw fire clay, and raw brick and tile clay	sewer pipe, flue lining, fire brick, related clay products, and small amount of ground and bagged fire clay	sewer pipe, flue lining, fire brick, related clay products, and small amount of ground and bagged fire clay

[1] Modified on other issues.

Case Name and Citation	Court and Date	Disposition on Appeal and Date	Products Claimed by U. S. as Base for Depletion	Products Claimed by Taxpayer as Base for Depletion	Products Finally Allowed as Base for Depletion
Richland Shale Products Co. v. United States, 168 F. Supp. 731	E. D. S. C., Oct. 31, 1958 (Timmerman, J.)		common brick and 4-inch drain tile	face brick, sewer pipe, drain tile, flue linings, wall copings	face brick, sewer pipe, drain tile, flue linings, and wall copings
Sparta Ceramic Co. v. United States, 168 F. Supp. 404	N. D. Ohio, Nov. 12, 1958 (Weick, J.)	Pending, 6th Cir., Nos. 13,838, 13,839	ground clay and shale before entering the pug mill, *or* common brick *or* unglazed tile	glazed and unglazed tile, mounted and packaged for shipment	unglazed tile, mounted for shipment
California Portland Cement Co. v. Riddell, 3 A.F.T.R. 2d 438	S. D. Cal., Nov. 21, 1958 (Mathes, J.)	Pending, 9th Cir., No. 16,438	crushed limestone	crushed and screened limestone, paving dust (fines), lime, cement clinker, and cement, in bags and in bulk	crushed and screened limestone, paving dust (fines), lime, cement clinker, and cement, in bags and in bulk
Centropolis Crusher Co. v. Bookwalter, 168 F. Supp. 33	W. D. Mo., Dec. 5, 1958 (Smith, J.)	Aff'd, 272 F. 2d 391, 8th Cir., Dec. 15, 1959 (Gardner, J., op.; Vogel, J., Mathes, J.)	limestone, crushed and sized	limestone, crushed and sized, and, in the case of 20% of its product, finely ground, in bags and bulk	pulverized limestone, crushed and sized, and, in the case of 20% of its product, finely ground, in bulk
Eastvale Clay Products Co. v. United States 4 A.F.T.R. 2d 5581	W. D. Pa., July 8, 1959 (Marsh, J.)	Pending, 3rd Cir., No. 13,090	raw fire clay	structural brick and tile, fire and ladle brick, and negligible amount of ground and bagged fire clay sold in such form, *or* ground and bagged fire clay	structural brick and tile, fire and ladle brick, and negligible amount of ground and bagged fire clay sold in such form
Standard Clay Mfg. Co. v. United States, 176 F. Supp. 590	W. D. Pa., July 8, 1959 (Marsh, J.)	Pending, 3rd Cir., No. 13,089	raw fire clay	structural brick and tile, fire and ladle brick, and negligible amount of ground and bagged fire clay sold in such form, *or* ground and bagged fire clay	structural brick and tile, fire and ladle brick, and negligible amount of ground and bagged fire clay sold in such form

Case Name and Citation	Court and Date	Disposition on Appeal, Date	Products Claimed by U. S. as Base for Depletion	Products Claimed by Taxpayer as Base for Depletion	Products Finally Allowed as Base for Depletion
Victorville Lime Rock Co. v. Riddell, 4 A.F.T.R. 2d 5463	S. D. Cal., July 27, 1959 (Mathes, J.)		crushed limestone	pulverized limestone in bulk and in bags, and incidental production of coarser sizes sold as such	pulverized limestone in bulk and in bags, and incidental production of coarser sizes sold as such
Dixie Fire Brick Co. v. United States, 4 A.F.T.R. 2d 5368	N. D. Ala., July 30, 1959 (Lynne, J.)	Pending, 5th Cir.	crude fire clay	ground fire clay in bulk and in bags	ground fire clay in bulk
Albin C. Halquist v. Commissioner, 33 T. C. 304	Tax Court, Nov. 25, 1959 (Drennen, J.)		crushed stone, *or* rough uncut stone	crushed and broken stone, flagstone, dry-wall stone, finished dimension stone	crushed and broken stone, flagstone, dry-wall stone, finished dimension stone
Monolith Portland Cement Co. v. United States, 60-1 U.S.T.C. ¶ 9187	S. D. Cal., Dec. 23, 1959 (Mathes, J.)		crushed limestone	cement	cement

Note: *Texas Carbonate Co. v. Phinney*, 3 A.F.T.R. 2d 1019 (W. D. Tex., Mar. 24, 1959), has been excluded because the only issue was bagging. The issue was resolved in favor of the taxpayer.

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No. 513

In the Supreme Court of the United States

OCTOBER TERM, 1959

UNITED STATES, PETITIONER

v.

CANNELTON SEWER PIPE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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REPLY BRIEF FOR THE UNITED STATES

I

THE RECORD IN THIS CASE SQUARELY AND INESCAPABLY PRESENTS THE STATUTORY ISSUE POSED BY THE PETITION

Taxpayer suggests (Br., Point I) that the record in this case does not raise the statutory issue presented by the Government—a suggestion which is remarkable not only because that issue is as central to this case as the Prince of Denmark is to *Hamlet,* but also because taxpayer advised this Court, in its brief in opposition to the petition for certiorari, that "The question in this case is *solely* one of statutory construction" (Br. in Op., p. 5; emphasis added). Taxpayer, having only recently assured the Court that this *sole* issue was correctly decided below, counsels today that this issue should be studiously avoided. It

was right the first time; the scope of "mining" under the depletion statute is the issue; and the question is whether that issue was correctly decided below.

The court below was under no illusions as to the basic issue in this case. "The question squarely presented," it stated (R. 267), is "whether the statutory language which defines, as a part of 'mining', 'all ordinary treatment processes normally applied by mine owners' to produce 'the commercially marketable mineral product or products', includes all processes necessary by a taxpayer to obtain a product *which can be sold by it at a profit*" (emphasis in original). This was the "overriding" issue, the Court of Appeals concluded, because the Government's proof clearly established that raw fire clay and shale were commercially marketable in the sense that they are mineral products which have commercial value and are bought and sold in "substantial" quantities (*ibid.*). The substance of this proof it described as follows (R. 270–271):

> * * * As it [the Government] points out, in this case it did not admit the nonmarketability of fire clay and shale. Indeed, the Government's evidence indicates that large quantities of fire clay and shale were sold during the tax year, 1951. Thus, in Indiana, of 82 companies engaged in the production or consumption of fire clay and shale, 32 purchased fire clay or shale, or both, for use in their manufacturing operations. Seven producers of fire clay and two producers of shale in Indiana engaged in nonintegrated operations, that is, strictly in the extraction of the raw fire clay

and shale and not in further processing. These companies necessarily took depletion on the raw fire clay and shale which they sold. Taxpayer's own expert witness, Haydn H. Murray, admitted, on cross-examination, that over 300,000 short tons of fire clay (of some 500,000 short tons produced) were sold in Indiana in 1951 rather than used by the producer in integrated manufacturing operations.[1]

Moreover, the District Court's conclusion that taxpayer is entitled to a recovery rests directly upon findings (1) that "finished products" constitute the "first 'commercially marketable mineral products' of the fire clay and shale mined by plaintiff" (Fdg. 13, R. 5), and (2) that the processes applied by taxpayer "were processes normally applied by mine owners or operators who are engaged in the manufacture of vitrified clay sewer pipe and related products" (Fdg. 10, R. 5). The first of these "findings" is untenable if the term "commercially marketable mineral products," as used in the statute, refers to the commercially valuable constituent of the mine, whether or not such constituent is actually sold, or could be profitably sold, by the individual taxpayer. The second "finding" is legally immaterial if the statute restricts the taxpayer to the processes normally applied by mine owners *as mine owners* (certainly, the normal reading), and does not include processes

[1] In addition to the Indiana producers to whom the Court of Appeals' opinion refers, the record shows that a Kentucky miner, directly across the river from Cannelton, Indiana, mined large quantities of both fire clay and shale for the use of the Owensboro Sewer Pipe Company and others. R. 166–167, 171–177.

which mine owners would use if they also happened to be sewer pipe manufacturers.

Since this record unmistakably establishes that there is a regular commerce in raw minerals of the kind which taxpayer mines, the case sharply poses the issue whether taxpayer, in the face of this established fact, could take depletion on the basis of the gross receipts received from the sale of manufactured sewer pipe. It is equally plain, as the Court of Appeals observed (R. 267), that if the legal theory upon which judgment was entered for the taxpayer does not satisfy the requirements of the statute, that judgment should not be sustained on appeal. Taxpayer had the burden of establishing its claim for refund and it must show that the judgment entered in its behalf has a proper legal foundation. It must affirmatively establish the correctness of *its* theory (*Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590, 593), *i.e.*, that it was entitled, as a matter of law, to recover upon a showing that it could not profitably market raw fire clay and shale. This would be so even if it could fairly be said that various legal arguments advanced by the Government in the District Court were erroneous. See *United States* v. *Bess*, 357 U.S. 51, 54–55; *Hormel* v. *Helvering*, 312 U.S. 552; *Helvering* v. *Richter*, 312 U.S. 561.

Taxpayer contends that in the District Court the Government attempted, but *failed*, to show that taxpayer could have competed effectively in the Indiana raw mineral market. Taxpayer also questions whether this Court may properly take notice of statistics (appearing in the "Minerals Yearbook" of the Bureau of

Mines and the "Census of Mineral Industries" prepared by the United States Department of Commerce) which show that raw fire clay and shale are generally sold throughout the United States. Neither of these arguments detracts from the conclusion that the issue presented by the Government's petition is squarely raised by this record.

If the Government's proof had shown that taxpayer could have profitably marketed fire clay and shale, that would have put an end to the case even on taxpayer's theory. An attempt to make such a showing and to negate, on the facts, the asserted basis of recovery is not, of course, a concession that taxpayer's theory is a correct one. The Government, moreover, did not rest on evidence bearing on the question whether taxpayer's costs permitted it to compete effectively in the Indiana mineral market. It undertook to show further—and it *succeeded* in showing—by the testimony of a series of witnesses that there was in Indiana (as well as in Kentucky) a regular and substantial commerce in raw fire clay and shale. See R. 84, 144, 148–149, 153–154, 157–158, 166–171, 175, 178–179. It also elicited, on cross-examination of taxpayer's expert, that 300,000 tons of raw fire clay were sold in Indiana alone in the tax year involved (R. 137). Thus, the Government proved—though that was not its burden—that on a correct legal theory there could be no recovery.

We believe further that, *if it were necessary*, figures of the kind incorporated in the United States Census might be the proper subject of judicial notice.

Since that is not necessary—the testimony of record being more than adequate—there is no need to labor the point. As the Court of Appeals recognized, the existence of a regular commerce in raw fire clay and shale was conclusively established (R.270–271).

We note finally that our contention as to the scope of mining under the depletion statute was raised in the pleadings and preserved throughout the District Court proceedings. Taxpayer's complaint alleged that it was entitled to compute its depletion with reference to its "gross sales of vitrified sewer pipe" (par. 21, R. 253); that the Commissioner had refused to allow depletion on that basis (par. 23, R. 254); and, further, that he had determined that certain of the processes included by taxpayer were manufacturing, rather than mining, processes and should be excluded from "gross income from the property" (*ibid.*). The Government's answer defended the correctness of the Commissioner's determination and denied that the statute permitted taxpayer to compute its depletion on the basis of the sale of its finished products (pars. 21, 23, R. 261). At the trial, as stated above, the Government offered evidence of a regular commerce in raw fire clay and shale. At the conclusion of the proceedings, the Government submitted a brief which argued (as to the statutory issue) two points: (1) "The gross income from mining is limited to the gross income from the sale of the first commercially marketable product of a given mineral"; and (2) "The first commercially market-

able mineral product of Pennsylvanian underclay is crude clay and shale."[2]

This case, as heard and decided below, stands squarely for the proposition that a miner-manufacturer who mines fire clay and shale, and thereafter fabricates those mineral products into sewer pipe, may be permitted to take depletion on a basis twenty or more times greater than non-integrated miners of fire clay and shale—some of whom appeared in the District Court in this very case. It has since been interpreted by other courts as authorizing the individual miner-manufacturer to compute his depletion allowance on the basis of the particular end product which he finds it profitable to make and sell. See *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398 (C.A. 8th); *Dixie Fire Brick Co.* v. *United States*, 4 A.F.T.R. 2d 5368 (N.D. Ala.); *Eastvale Clay Products Co.* v. *United States*, 4 A.F.T.R. 2d 5581 (W.D. Pa.); *Standard Clay Mfg. Co.* v. *United States*, 176 F. Supp. 590 (W.D. Pa.). The *sole* issue (as taxpayer itself recognized only a few months ago) is whether the

[2] In the course of the argumentation, it was stated, *inter alia*, that "percentage depletion is to be based [on] the *first* commercially marketable mineral product and not just any mineral product a given producer may decide to produce" (pp. 14–15); that "[i]f Congress had intended to say 'processes normally applied by mine owners and operators' to arrive at their commercially marketed product it could have done so" (p. 21); and that "it is the deposit which is depleted and which is subject to an allowance for depletion, not the finished manufactured product" (p. 22). A copy of this brief is being filed with the Clerk of the Court.

statute, as enacted by Congress, authorizes such results.[3]

II

TAXPAYER'S VIEW THAT THE PRODUCT ON THE BASIS OF WHICH MINERAL DEPLETION IS TAKEN MAY VARY FROM TAXPAYER TO TAXPAYER WITHIN THE SAME BRANCH OF THE MINING INDUSTRY RESTS UPON A MISCONSTRUCTION OF THE STATUTE AND IS IRRECONCILABLE WITH THE LEGISLATIVE HISTORY. THE "CUTOFF" IS THE BASIC MINERAL PRODUCT FIT FOR SALE OR COMMERCIAL USE

A. One thing emerges plainly from the two extensive opening briefs filed in this case: that there is a fundamental difference between the litigants as to the proper interpretation of the words "commercially marketable mineral product," as they appear in the statute. The Government does not assert, as taxpayer suggests, that those words may be read out of

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[3] Taxpayer suggests that the conclusion to the Government's brief—suggesting that the case be remanded so that taxpayer's gross income from mining may be determined in the light of the correct legal criteria—indicates that the Government is seeking a trial *de novo*. On the contrary, we contend that the evidence and findings below require the conclusion that taxpayer's gross income from mining is to be computed with reference to the value of its raw fire clay and shale, rather than with reference to the value of its finished products. We suggest a remand because it is properly the function of the District Court to make the necessary computations. Under the pertinent Regulations (see our main brief, pp. 60, 95–96), if an integrated producer does not sell the basic mineral product, it must be determined if there is a representative field or market price which may be utilized. If there is none, there must be a constructive computation of gross income from mining, *i.e.*, one must determine the ratio of mining costs (including ordinary mineral processing) to non-mining costs and apply the percentage represented by the former to the gross receipts received from the finished products actually sold, thus eliminating the values attributable to the extraordinary processing.

the statute. Nor does it claim for a moment that the words are not an integral part of the statutory definition which Congress has prescribed for purposes of determining the depletion base.[4] The dispute is as to what the words mean—what the "commercially marketable products" rule (as taxpayer phrases it) is.

Simply stated, the Government's view is that it is an industry-wide rule which restricts miners of the same class to the same basic marketable product. Applied to this case, the rule means that miners of fire clay and shale are to compute the gross income from their mining properties on the basis of the value of those minerals in raw form—the record conclusively establishing that they are marketable in that form. The Government's interpretation of the statutory definition precludes the view that the non-integrated miner of fire clay and shale is to get but a small fraction, per ton of mineral, of what the integrated miner obtains.

Taxpayer's view, candidly stated in its brief, is that the standard may vary from taxpayer to taxpayer, so that one will take depletion on a relatively primitive product and another on an advanced manufactured product. Thus, taxpayer flatly states (Br., p. 57) that a taxpayer's gross income is not to be determined "on the basis of the first commercially marketable product obtained by some other miner or miners of the same mineral." Its argument, in es-

[4] We *do* stress that they are to be read in conjunction with the antecedent language—"ordinary treatment processes normally applied by mine owners or operators in order to obtain * * *."

sence, is that the first product which the individual producer finds it *profitable* to make is the product with reference to which he may compute depletion. This taxpayer, making sewer pipe which sells for approximately $40 a ton, claims depletion on that basis, whereas other miners of the same minerals must take it on the basis of their sales of raw fire clay and shale, minerals sold in most instances for less than $2 a ton. Presumably, if taxpayer were to find it profitable to begin making all of its fire clay and shale into substantially more expensive products, selling at $80, $120 or $160 a ton, it would claim an allowance for exhaustion of its clay on a basis two or three or four times greater than the base which it now claims (a base which already yields it more than double the price which it would have to pay to buy fire clay and shale on the market).[5]

Congress, to be sure, recognized that most minerals require treatment to give them realizable value.

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[5] It is notable that in 1957 taxpayer began obtaining its fire clay and shale from a miner across the river in Kentucky (see R. 68)—the same miner who in 1951 (the taxable year here involved) delivered clay to the Owensboro Sewer Pipe Company at $1.40 a ton (R. 163–172). As taxpayer's vice-president testified (R. 68), the clay across the river is suitable and is cheaper. Apparently, Cannelton now claims the economic interest in this mine—having leased the land for the sum of $1 (R. 179)—and asserts, *on the basis of the value of its sewer pipe*, a depletion allowance of approximately $1 a ton for minerals which the contract miner is able to deliver at a price in the neighborhood of $1.40 a ton. Taxpayer assures this Court (Br., p. 116) that such a result is "not discrimination." We would say that it documents the proposition that non-integrated miners will not survive if integrated miners may completely pervert the depletion allowance.

Therefore, instead of restricting depletion to the value of the mineral in its natural state, it undertook to allow depletion on the basis of the value of the mineral after it had been treated (by "ordinary treatment processes normally applied by mine owners or operators") to that initial point where it was in a condition fit for sale or use and could ordinarily be associated with a field or market price. We do not read "commercially marketable mineral product" out of the statute. We say, rather, that those words refer to the commercially valuable constituent of the deposit—or, to use the words of the Chairman of the Tax Committee of the American Mining Congress, to the mineral put in "marketable condition" (see our main brief, p. 87). This view, we believe, gives effect to the underlying purpose of depletion—to allow an ascertainable and reasonably uniform measure of compensation for the exhaustion of the mineral asset itself—and, at the same time, it gives meaning to all of the language of the statutory definition. Without restating at length the arguments made in our original brief, we point out in summary form—

(1) "Ordinary treatment processes normally applied by mine owners or operators" can hardly be taken to contemplate the inclusion of processes which a mine owner could never normally apply unless he also happened to be something else in addition, *i.e.*, a fabricator or manufacturer. (We are not saying, as taxpayer appears to believe, that the line which determines what is included within the statutory definition of mining and what is not is a line to be drawn between "mining" and "manufacturing." Under our

view, manufacturing processes are, as a practical matter, excluded. The reason is that we believe that there is no instance in which it can be shown that such processes are normally applied by mine owners in order to obtain the valuable constituent of a mine. *Non*-manufacturing activities are also broadly excluded where they are unnecessary for purposes of putting the particular mineral in marketable condition.)

(2) The processes which Congress has set forth as a "reasonable specification of what are to be considered [includible] processes for various *kinds* or *classes* of mines" [6] fall into three categories: (a) those which involve "unscrambling" of the valuable constituent, *i.e.*, its separation from waste matter and impurities; [7] (b) those which involve preparation for shipment—processes such as drying, screening, or crushing, where such are necessary for the particular mineral concerned; (c) activities which are a necessary incident of (a) or (b), such as transportation to the place where the ordinary treatment processes are applied.

(3) The "commercially marketable mineral product" to which Congress made reference is the product *obtainable by* application of the *ordinary* treatment processes which mine owners normally apply—from which it follows that more advanced products obtained

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[6] S. Rep. No. 627, 78th Cong., 1st Sess. (App. B, pp. 210–211; emphasis added).

[7] As shown, *infra*, pp. 21–26, 30–32, cyanidation and leaching, listed processes to which taxpayer makes particular reference, are separation processes which Congress has allowed for that reason.

by processes which are not the ordinary and normal processes of miners are not the products to which Congress had reference.

In the usual situation—as Congress contemplated [8]—it is a simple matter to determine the first marketable product of a branch of the mining industry. For example, if there is a regular commerce in iron ore of shipping grade (as is, of course, the case), that, as all miners of iron ore are assuredly aware, is the commercially marketable mineral product produced by that branch of the mining industry. Iron ore is no less a marketable product because some integrated miner-manufacturers find it unprofitable (or less profitable) to sell the ore and proceed to make it into pig iron or structural steel. This case falls into the same category, since the record shows a regular commerce in raw fire clay and shale. The sales furnish conclusive proof that these minerals are in commercially marketable condition in their raw form.

Admittedly, the more difficult case is one in which there are no sales of the mineral prior to manufacture because *all* of the mines are part of integrated enterprises. We do not think that the statute need be read, or should be read, to permit an extension of depletion on the basis of industry-wide vertical integration. Such integration does not prove that the mineral must be processed further to be put in a condition where it is commercially valuable; it simply reflects the fact that each producer of the mineral has provided his own market intramurally.

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[8] See main brief, Point II, pp. 43, 49–51.

But even if one were to conclude, contrary to our view, that the words "commercially marketable" dictate a requirement that sales in the industry be shown before a cutoff can be established, that would not avail this taxpayer. Such a conclusion cannot rest on a case such as *Merry Brothers,* in which the court took the view that the total absence of sales of brick clay (as was assumed on the pleadings) enabled producers of that mineral to take brick as the basis of depletion. Since, as found by the court below, there *is* traffic in fire clay and shale, taxpayer must take another long and significant step; it must argue that a product is not to be deemed commercially marketable, *even though widely sold,* if a particular producer could not sell it *profitably.* It must convince the Court that the statute permits those mines which are by hypothesis less valuable (those that could not compete effectively in the market) to get virtually unlimited depletion allowances (by going on to expensive finished products whose ultimate sales prices bear no fixed relation to the value of the ingredient mineral), and will confine only the more valuable mines (those which can clearly produce below the market price) to processes within the concept of mining.

B. Such, broadly, is the difference in approach between the Government and respondent. As to the specific objections which taxpayer has advanced to the arguments elaborated in our main brief:

1. Taxpayer argues that the plural reference to "products" in the phrase "commercially marketable mineral product or products" indicates that Congress did not intend to confine depletion to a single basic

product for each branch of the mining industry. (Br. 59–60.) As we pointed out in our main brief (pp. 27–28), however, the plural reference to "products" appears to be merely a recognition that one mining operation (as in this case) may yield more than one mineral (here fire clay *and* shale) and that a single ore frequently yields different minerals.* Congress' awareness of this is reflected in Section 114(b)(4)(B), subparagraph (iv), which speaks of the "processes used in the separation or extraction of the product or products from the ore * * *." Taxpayer says that this explanation "inherently concedes that the statutory phrase, 'the commercially marketable mineral product or products,' refers to the 'product or products' of a particular mining operation, not to a single, industry-wide 'basic product' of the particular mineral." (Br. 60.) But recognition of the fact that a single mining operation may produce more than one mineral certainly does not answer the question, "What are the depletable mineral products"? In our view, "product or products" refers to the mineral or minerals, and the term "commercially marketable mineral product or products" refers simply to the mineral or minerals put in marketable condition. We do not say that the correctness of this construction is conclusively established by the reference in subparagraph (iv) to

* "In the mining industry, gold, silver, copper, lead, and zinc are closely related in both the genesis and the geologic occurrence of their ores, as well as in mining and in metallurgical treatment. Of their ores some contain all five metals, many contain three or four, and few contain only one. * * *" *Mineral Resources of the United States* (1930), Part 1, Metals, U.S. Dept. of Commerce, Bureau of Mines, p. A121.

the minerals as the products, but the reference certainly corroborates, rather than refutes, our view.

It is commonplace, we point out, to refer to the valuable constituent of a mineral deposit as the "mineral product." As far back as 1916, the depletion statute—which at that point had no concern with marketability, but referred to value "at the mine"—spoke of the mineral as the "product" of the mine.[10] Similarly, the mining industry itself refers to the minerals (with the necessary processing to make them marketable) as the "products" of mining.[11] The word "product" is frequently used interchangeably with "mineral product"—both referring to the valuable constituent of the mineral.[12]

It is clear, moreover, that until recently the mining industry had no difficulty with the import of the definition. After 1943, when the "commercially marketable" language first appeared in the statute, a veritable parade of mining industry representatives appeared before Congress, session after session, to seek percentage depletion on minerals for which that method had not yet been authorized. As pointed out in our main brief (pp. 76–80) and fully documented in

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[10] Revenue Act of 1916, Sec. 5 (App. B, pp. 2–3); see, also, Treasury Regulations 33 (1914 ed.), Art. 142 (App. B, pp. 1–2), and Treasury Regulations 62 (1922 ed.), Art. 201 (App. B, p. 6).

[11] See, *e.g.*, the testimony of Robert M. Searles during the 1942 Silver Subcommittee Hearings (App. B, pp. 165–166); Dickinson, *Depletion—Gross Income—The Property*, 18–19 Mining Congress Journal (1932–1933) (App. B, pp. 466–468).

[12] See *Forbes* v. *Gracey*, 94 U.S. 762, 766; Hoover, *The Economics of Mining* (1948 ed.), p. 168.

our Appendix B (pp. 316–466), not a single representative of any branch of the mining industry ever suggested that application of the statute to the mineral on which depletion was being sought would confer a right to take depletion on any product more advanced than the particular mineral put into marketable condition. We have listed the products and processes to which they made reference (App. B, following page 500). It is notable that taxpayer has been unable to find a single flaw in this documentation.[13]

2. Taxpayer repeatedly argues (Br. 45–49, 53–55, 61, 63, 64–66) that the Government's interpretation of the statute does not give effect to the words "commercially marketable mineral product."

Its real complaint, however, is that we do not give them an effect which will permit different miners of the same class to take depletion on a disparate basis depending solely upon the degree to which each is integrated. The effect of this language, in our view, is that all miners of the same class may

[13] The farthest taxpayer goes is to attempt to dissociate itself from those who sought depletion for refractory clay on the basis of the "value" of the "raw materials used" (Gov't's main brief, pp. 79–80). It says (Br. 93, n. 45) that since fire clay is a term somewhat broader than the term "refractory clay" (including some clays which are not distinctively refractory), the spokesman for the users of refractory clay did not speak for all users of fire clay. We point out that fire clay and refractory clay (terms which very substantially overlap) were bracketed together by Congress and granted depletion at the same time. Taxpayer's strained argument is to be contrasted with its emphasis at the trial on the proposition that its fire clay had high value because it was "definitely a refractory clay" (R. 119)—indeed, the most refractory clay in Indiana (R. 115–116).

include in "mining" those processes which must be applied in the industry in order to extract and separate the valuable constituent of the deposit and put it into marketable condition. This is the natural construction of the statute—one in keeping with the natural assumption that mining operations would not be conducted if they did not result in obtaining a form of the mineral which was commercially marketable. Congress, we stress, did not refer to the product marketed by each taxpayer but to the marketable product.

The point which clinches, as noted above, is that effect must also be given to the restrictive clause which precedes the reference to the "commercially marketable mineral product," namely, the "ordinary treatment processes normally applied by mine owners and operators in order to obtain" that product. Taxpayer is forced to argue that the words "ordinary treatment processes" includes processes which are employed by those fire clay miners who are also sewer pipe manufacturers, and to rest upon the District Court's finding that Cannelton's processes are normal for mine owners or operators *"who are engaged in the manufacture of vitrified clay sewer pipe and related products"* (Fdg. 10, R. 5; emphasis added).[14] This, despite the fact that we are dealing with a definition of "mining," incorporated in a statute designed to compensate for the exhaustion of the mineral!

[14]Apparently, the only situation in which taxpayer would give effect to the words "ordinary treatment processes" is where a taxpayer, having obtained one product which he could sell at a profit, proceeds to go further in order to obtain a still more valuable product.

3. Contrary to taxpayer's suggestion (Br. 51–53), we are not saying that there is a precise scientific or technical line—one on which all experts would agree—as between mining and manufacturing, or that Congress was attempting to draw such a line. Smelting and refining, for example, are extractive processes—they are certainly not manufacturing and a few experts might even designate them as included in "mining";[15] yet Congress has specifically excluded them. The reason is that the ore concentrate—obtained prior to smelting—is valuable and is, indeed, sold by the non-integrated miner (although it has long been true that most of the principal metals are very largely mined by integrated miners who do their own smelting and refining, and, frequently, their own fabrication).[16]

What *is* established by the "reasonable specification" of processes incorporated in the statute is that Congress has proposed only to allow those ordinary processes employed by the miner, in accordance with regular industry practices, to get something of value:

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[15] Smelting and refining are ordinarily classified as metallurgy. See Newton, *Introduction to Metallurgy* (1948 ed.), p. 1.

[16] The Shepard Report observed, in relation to iron ore, "Probably 95 percent of the entire production is owned or contract-controlled by the smelting companies." Preliminary Report on Depletion, Reports to the Joint Committee on Internal Revenue Taxation from its Staff (1930), Vol. 1, Part 8, p. 73. The percentage of integration in the copper industry is approximately the same. House Hearings, 1959 (Hearings before the House Committee on Ways and Means on Mineral Treatment Processes for Percentage Depletion Purposes, 86th Cong., 1st Sess.), p. 72.

the useful or saleable product which is the primary object of mining. This standard will frequently exclude non-manufacturing activities. As previously observed, the listed processes fall into three classes: those which are extractive or separative; those which are necessary to put in shipping grade or form; those which are necessary or incidental to the foregoing. The significant point is that Congress has in no instance provided for the inclusion of any process which would take the valuable product of the mining operation—the mineral in its marketable condition—and convert it into a new and different product.

4. In an effort to shake the strong evidence, both in the statute itself and in its history, that Congress proposed to treat each class of miners alike, taxpayer makes an extended argument (Br., pp. 62–63, 84–92) based upon the fact that Congress, in 1943, provided for the allowance of the cyanidation process (used by some miners to extract gold from gold ore) and of leaching (a method sometimes used to extract copper from copper ores). Taxpayer apparently agrees (App. II, pp. 6–8) that these are treatment processes by which the valuable constituents are derived from the ores. What it suggests is that the use of these metallurgical methods yields a purer or more refined mineral product than is obtained by concentration processes (separation by essentially physical means),[17] and that this therefore tends to show that Congress did not propose (as the Government argues) to treat all miners of the same class alike.

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[17] See App. B, p. 496.

The argument, in short, is that Congress has allowed latitude as to the processes which may be employed by the miner to get the valuable constituent of the deposit and that the availability of alternative methods results in the obtaining of different products. Apart from the fact that the argument is not well grounded—taxpayer has made serious errors in its discussion of cyanidation and leaching (as we point out immediately below)—it falls far short of the point which taxpayer must prove. There is a great gap between the proposition that different processes may result in variation in the purity of minerals extracted and the proposition (which Cannelton must establish) that a taxpayer, having obtained the valuable constituent of the mineral, may proceed to include further processing employed in order to convert the first valuable product into a new and different one. To make out an analogy to the instant case, taxpayer would have to show that Congress was prepared to allow individual miners of gold to take depletion on golden chandeliers and individual miners of copper on copper fixtures—subject only to a showing that they could not profitably sell the gold or copper.

Cyanidation of gold: Taxpayer's brief assumes that gold bullion [18] is the first "commercially marketable mineral product" obtained by miners who use the cyanide process, and reasons from this that Congress has allowed such miners a depletable product different

[18] The United States mint accepts shipments of gold and silver, bullion and otherwise, which have a purity of 20 percent or more. *Mineral Facts and Problems* (1956), Bulletin 556, Bureau of Mines, p. 319.

from that obtained by those who extract gold from ore by concentration methods.[19] (When concentration processes are used, there is no question that the ore concentrate is the commercially marketable product since smelting—the next process—is specifically excluded by the statute.) It is true that if all steps in the cyanide process are performed, the last step is one in which gold precipitate (obtained by the prior steps) is melted with a flux and cast into bars for shipment,[20] and that this final step is akin to (or a substitute for) smelting.[21]

We do not, however, agree with taxpayer that the statute permits the inclusion of this last step in the depletion base. What the statute authorizes as an "ordinary treatment process" is "*beneficiation by* concentration * * * *cyanidation,* leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes * * *" (emphasis added). "Beneficiation" is virtually synonymous with "concentration"[22] (applied in order to get the ore concentrate

[19] The cyanide process is used primarily in lode mining. See Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 530; *Mineral Facts and Problems* (1956), *supra*, pp. 317–319; *Gold, Mineral Facts and Problems* (1960 ed.), U.S. Dept. of the Interior, Bureau of Mines, pp. 2–3.

[20] *Mineral Facts and Problems* (1956), *supra*, p. 318; Dorr and Bosqui, *Cyanidation and Concentration of Gold and Silver Ores* (1950 ed.), p. 201; Stoughton and Butts, *Engineering Metallurgy* (1926 ed.), p. 348; Henderson, *Metallurgical Dictionary* (1953 ed.), "cyanidation," p. 99.

[21] *Gold, Mineral Facts and Problems* (1960 ed.), U.S. Dept. of the Interior, Bureau of Mines, p. 3.

[22] See definitions, App. B, p. 496.

which goes to the smelter); in relation to smelting, it means "to concentrate or otherwise prepare for smelting." [23] The cyanide precipitate (equivalent to the concentrate obtained by other methods) is a recognized mineral product (one which is in fact purchased by smelters in substantial quantities) [24] and constitutes the first marketable product under the statute.

This is not merely the view of the Government; it has been that of the mining industry. The industry complaint in 1942 was that the Treasury Regulations (which affirmatively allowed "other processes to the extent to which they do not beneficiate the product in greater degree * * * than crushing and concentrating" (App. B, p. 136)) were being too narrowly applied, and that processes equivalent to concentration (especially the cyanidation of gold and the furnacing of quicksilver) were being disallowed.[25] What the industry sought was the equivalent of concentration—that miners of the same mineral, using different methods, be put on the *same* footing (the direct opposite of taxpayer's thesis). Mr. Fernald, Chair-

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[23] *Webster's New International Dictionary* (1949 ed.).

[24] See *Mineral Commodities of California*, Bulletin 176 (1957), State of California, Department of Natural Resources, p. 223; *Minerals Yearbook* (1951), U.S. Dept. of the Interior, Bureau of Mines, p. 630; *1954 Census of Mineral Industries*, U.S. Dept. of Commerce, Bureau of the Census, Vol 1, pp. 10F–1, 10F–17, 10F–21; Taggart, *Handbook of Mineral Dressing* (1945 ed.), p. 2–75.

[25] See our main brief, pp. 58–59, 61–63; House Hearings, 1942 (App. B, 152–153); Silver Subcommittee Hearings, 1942 (App. B, 172, 174–175, 176–178, 186, 188–189); Senate Debate, 1942 (App. B, p. 197); Senate Hearings, 1943 (App. B, pp. 202–204); Fernald, *Depletion and Related Problems Under the Revenue Act of 1942*, 21 Taxes, The Tax Magazine 141, 143 (1943) (App. B, p. 484).

man of the Tax Committee of the American Mining Congress, stated (App. B, 184) that one should not "exclude the entire cost of the cyaniding process, but only so much of that as was considered as going beyond what a concentrating cost would have been * * *."[26]

Leaching of Copper: Taxpayer also asserts that the leaching of copper results in a "different and more processed" product than the ore concentrate (which is the commercially marketable product obtained by miners who use the concentration method). In this instance, we are not told what the "different and more processed" product is. As to both, taxpayer says that the product is "impure copper." (App. II, pp. 10–11.) Apparently, taxpayer's point is that the leaching of copper, like the cyanidation of gold, is an alternative to smelting and is allowed by the statute, although smelting is not. (See Br. 86.) But, here again, taxpayer has ignored the statute.

Depending upon the grade or type of ore, copper ore is either concentrated or leached.[27] The ore con-

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[26] Like cyanidation, amalgamation produces a product labelled as a precipitate in official publications. See note 24, *supra*. It is only when the amalgamation process is combined with the last part of the cyanidation process that a gold bullion is obtained. See, *e.g.*, *Mineral Commodities of California*, Bulletin 176 (1957), pp. 221–222. That step is not included in the statutory "ordinary treatment processes" for the same reason that the last step in cyanidation is not included.

[27] *Mineral Facts and Problems*, Bulletin 556 (1956), Bureau of Mines, p. 232; *Materials Survey* (Sept., 1952), *Copper*, National Security Resources Board, U.S. Department of the Interior, Bureau of Mines, pp. II–25, II–57 to II–58; see, also, definitions of leaching and precipitation in App. B, p. 499.

centrate obtained from concentrating the higher grades is sent to the smelter, as taxpayer says, but so is the precipitate which is obtained by one method of leaching low-grade oxidized ore.[28] Another method of leaching, in which the last step is called "electrolytic deposition" or "electrolytic precipitation," produces a refined, high-quality copper,[29] "bypassing the smelter entirely."[30] This is apparently the "different, more processed" product of which taxpayer speaks. But the process by which it is obtained, "electrolytic deposition," is expressly excluded by the same statutory provision which excludes smelting.[31]

Taxpayer's examples support, rather than impair, the Government's thesis that Congress proposed to treat all miners of the same class alike. They show that the statute does not operate to permit miners of the same mineral to take depletion on different marketable products (as taxpayer claims), but that it cuts miners off at the *basic* marketable product of

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[28] *Mineral Facts and Problems*, Bulletin 556 (1956), *supra*, p. 232.

[29] *Materials Survey, Copper*, *supra*, pp. II–25 and II–58; *Mineral Facts and Problems*, Bulletin 556 (1956), *supra*, p. 232; see also, Henderson, *Metallurgical Dictionary*, "electrolytic deposition," p. 120; Bateman, *Economic Mineral Deposits* (1952 ed.), pp. 414–415; Fay, *Glossary of Mining and Mineral Property* (1947 ed.), "deposition," p. 211.

[30] *Mineral Commodities of California*, Bulletin 176 (1957), *supra*, p. 176.

[31] This would be true even if "electrolytic deposition" were not excluded by name, since it is only "beneficiation by * * * leaching" (leaching which is equivalent to concentration) which the statute includes in the listed "ordinary treatment processes."

the industry, irrespective of the processes employed to obtain it.[32]

[32] To the extent that miners of bituminous coal sell to some industrial users without breaking and sizing the coal (see our main brief, p. 28; taxpayer's brief, p. 62; taxpayer's App. II, p. 8), it may be argued that Congress, which has specifically allowed breaking and sizing (Section 114(b)(4)(B), subpara. (i), relating exclusively to coal), has permitted the inclusion of processes which are not essential to make bituminous coal marketable. In various respects, coal has been the subject of individual consideration by Congress. See brief filed by the National Coal Association, *amicus curiae*. The argument cannot be carried over to subparagraphs (iii) and (iv) (covering minerals other than coal and sulphur, dealt with in subaparagraphs (i) and (ii)). Subparagraph (iii) allows only the inclusion of named processes to the extent that they are necessary to bring the mineral to shipping grade and form. Subparagraph (iv) allows only the inclusion of named processes to the extent that they are necessary to separate or extract the commercially marketable product from the ore. Moreover, as to the minerals covered by all four subparagraphs, the dominant consideration is that Congress has never countenanced the inclusion of any process which would take the valuable constituent of the mine and convert it into a new and different product. The National Coal Association does not claim in its brief that a coal producer can proceed to take depletion on coke (although there are individual producers of coal who are claiming depletion on more advanced products). Indeed, it carefully refrains from endorsing the Cannelton theory, arguing that all of the processes listed for coal are includible irrespective of any marketability test (Br., pp. 7–8, 13, 18).

We note further that we subscribe to National Coal Association's reading of the legislative history (brief, *amicus curiae*, pp. 15–16). We agree that cleaning, breaking, sizing and loading of coal were allowed because they were a normal part of preparation "at the mine for shipment"; that the processes specified for sulphur were allowed on the same basis; and that the purpose, in respect to other minerals, was to allow processes "which resulted in a product of a mine (i.e. mineral concentrates) as distinguished from a manufactured or refined product." *Id.*, p. 15.

5. Taxpayer's discussion of the legislative history (Br., pp. 76–105) is notable for what its does not argue. It fails to show that Congress' attempt to provide a reasonable specification of allowable treatment processes was designed, in any instance, to permit a producer to claim depletion on processes used to convert a commercially valuable mineral constituent into a new and different product.[33] It fails to meet the thesis, fully developed and documented in our main brief, that Congress expressed its determination to establish a cutoff at the point where the basic mineral product is obtainable, and thus to avoid preference of the integrated miner over the non-integrated miner. It ignores the Government's showing that all of the branches of the mining industry which requested percentage depletion sought it on the basis of the valuable constituent of the mining operation, not on the basis of products subsequently manufactured.[34]

Instead, taxpayer seeks to show (in keeping with its argument as to cyanidation and leaching, discussed

[33] Taxpayer does seek support (Br., pp. 93–94) from a letter written by Senator George to the Commissioner of Internal Revenue in 1955 on the subject of brick manufacture. This letter was written twelve years after the statutory definition of mining was adopted and four years after brick and tile clay had been granted percentage depletion—at a time when miners of clay located in Georgia and elsewhere were contending, in litigation, that they should be allowed depletion on brick. Assuming that this is appropriate "legislative history," the fact remains that the basis of Senator George's argument was that brick clay has "no commercial value" until made into brick—an argument which hardly aids Cannelton, since the Court of Appeals has found in this case that fire clay *does* have commercial value.

[34] See note 13, p. 17 *supra*.

above) that Congress proposed to allow certain alternative treatment processes, knowing that this would result in significant variations in the degree of refinement characterizing the treated mineral. As we have already indicated, and shall point out more fully below, such modifications as Congress made in 1943, when it wrote the statutory definition of "mining," were made precisely because Congress accepted an industry complaint that the Treasury, in applying the 1932 Regulations, was failing to allow certain *equivalent* processes which should have been allowed under the Regulations. Congress acted in order to assure substantial equivalence, not in order to permit significant variation.

Taxpayer advances a further argument based upon Congress' failure to act upon legislative recommendations made by the Treasury in 1954, 1958 and 1959.

We turn to these two lines of argument.

(*a*) In our presentation of the legislative history, we argued that the Treasury Regulations promulgated under the 1932 Act (Regulations which listed includible processes, App. B, p. 136) undertook to provide an industry-wide cutoff, and that Congress followed the same approach when it wrote the statutory definition of "mining" in 1943 (albeit it made certain additions to the processes named in the outstanding Treasury Regulations on the ground that those it was naming were equivalent to concentration and should not have been disallowed by Treasury, as they had been after 1940). Taxpayer argues, in response, that the 1932 Regulations, as published, did not reflect

either the Congressional intent or the actual understanding reached by the Treasury and the mining industry representatives (Br., pp. 84–85); that Congress, in 1943, showed that it rejected the approach reflected in the Treasury Regulations because it wrote into the statute various processes (cyanidation; leaching; the furnacing of quicksilver) which "go beyond concentration" (Br., p. 86); and that the 1932 Regulations and the 1943 statute have nothing in common beyond the fact that "both have four lists of processes" (Br., p. 91).

Taxpayer hinges its argument upon the conferences between mining representatives and Treasury officials in relation to the 1932 Regulations. It relies upon a statement by L. H. Parker (Br. 84–85)—made in 1947 on behalf of the National Coal Association and in a context having no relation to processes such as cyanidation, etc.—that the agreement reached at the 1932 conference (which he does not say he attended) was one which was *not* reflected in the 1932 Regulations *as issued*. Apart from the fact that Mr. Parker was obviously mistaken,[35] this is certainly not what Congress was told in 1942 when the mining industry sought legislation to reinstate the original (pre-1940) Treasury practice under the 1932 Regulations. Mr. McLaughlin, representing the Tax Committee of the American Mining Congress, advised Congress that he

[35] See the material submitted to the Treasury by the American Mining Congress, reprinted in taxpayer's Appendix II, pp. 132–160, and compare the original draft of these 1932 Regulations (App. II, p. 134) with the final Treasury Regulations 77 as issued (App. B, p. 135).

had participated in the conferences which preceded the adoption of the 1932 Regulations and that [36]—

> When the 1932 regulations were adopted, it was understood by the representatives of the mining industry that the omission of a complete recital of the many processes by which ores are *beneficiated* was simply to avoid burdening the regulations with a lengthy and possibly incomplete statement, and that the meaning of the act was met by the inclusion of phrases such as "other processes" which were deemed adequate to cover other common methods of treatment *similar in their function* to those specified. *With the regulations in this form,* it was believed that the administration of the law would not depart from what we had been informed was the intent of the Members of Congress who had sponsored the legislation.
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> * * * * *
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> That this understanding was well founded and expressed the agreement reached at this conference with Assistant Secretary Douglas is clearly borne out by the action of the Bureau of Internal Revenue for the next 8 years in accepting and settling tax returns based upon it. During this period, the law with regard to percentage depletion was repeatedly reenacted and the regulations remained essentially unchanged. For example, in the case of gold mines, common processes such as amalgamation and cyanidation were regarded as the *equivalent* of concentration by gravity or flotation, * * *. [Emphasis added.]

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[36] Senate Hearings, 1943 (App. B, pp. 202–203).

Mr. Fernald, Chairman of the Tax Committee of the American Mining Congress, also emphasized[37] that "[a]s to the Treasury interpretation, the original regulations prescribed that * * * a *cut-off* should be made at 'concentrating (by gravity or flotation) and other processes *to the extent to which they do not beneficiate the product to a greater degree* * * *,'" and that "under this regulation" the Treasury "in practice considered cyaniding as *substantially equivalent* to concentrating * * *" (emphasis added). Mr. Fernald has also explained (although not to Congress) that[38]—

> * * * After extended hearings on this subject [the proposed 1932 Regulations] before the Assistant Secretary of the Treasury, substantial modifications were made in the Bureau's original proposals and the Regulations as thus finally approved (Regulations 77, Art. 221) stood substantially unchanged until in 1940 when certain apparently minor changes therein were made in 1940 by T.D. 4960 (1940–1 C.B. 38). * * *

Other industry representatives who appeared at the hearings before Congress similarly placed emphasis upon cyanidation, leaching, and the furnacing of quicksilver as *equivalent* to concentration.[39] Mr.

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[37] Silver Subcommittee Hearings, 1942 (App. B. pp. 188–189).

[38] Fernald, *Depletion and Related Problems under the Revenue Act of 1942*, 21 Taxes, The Tax Magazine, 141 (1943) (App. B, pp. 483–484).

[39] Silver Subcommittee Hearings, 1942 (App. B, pp. 172, 174, 177, 178).

Fernald explained that the Treasury's early practice (which he sought to reinstate) permitted cyanidation to the extent that it did not go beyond concentration.[40]

The furnacing of quicksilver, applicable to only one mineral, was allowed on industry representations that it was an equivalent to other named processes and was necessary to obtain the marketable product.[41] Mr. Fernald, among others, told Congress that "the furnacing or retorting of quicksilver ores is generally regarded as the equivalent of concentration."[42] In contrast to taxpayer's statement that there was an early agreement with respect to the furnacing of quicksilver as a process going "beyond concentration" (Br. 85–86), Mr. Williston (President, Oregon Mining Association) stated that "when the ruling of the Treasury was passed, * * * quicksilver was not considered to be valuable, nobody paid any attention to it."[43]

The accuracy of taxpayer's declaration (Br., pp. 90–91) that Congress' specification of allowable processes bears no resemblance to the prior Treasury

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[40] *Id.* (App. B, p. 184).

[41] House Hearings, 1942 (App. B, pp. 152–153); Silver Subcommitee Hearings, 1942 (App. B, pp. 161–162, 165, 172–173, 188); Senate Hearings, 1943 (App. B, p. 203).

[42] Silver Subcommittee Hearings, 1942 (App. B, p. 188).

[43] *Id.* (App. B, p. 173).

Regulations " may be readily judged by a comparison of the two:

Treasury Regulations 77	*Section 114(b)(4)(B)*
(1) In the case of coal—cleaning, breaking, sizing, and loading at the mine for shipment;	(i) In the case of coal—cleaning, breaking, sizing, and loading for shipment;
(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading at the mine for shipment;	(ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment;
(3) In the case of iron ore and ores which are customarily sold in the form of the crude mineral product—sorting or concentrating to bring to shipping grade, and loading at the mine for shipment; and	(iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and
(4) In the case of lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product — crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined	(iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treat-

" Compare the contrary view expressed in the brief of the National Coal Association, *amicus curiae*, pp. 15–16. The Association finds (*id*, p. 15) that the present statute "closely parallels" the 1932 Regulations and that the "processes enumerated * * * were clearly of the type which were regarded as processes which resulted in a product of a mine * * * *as distinguished from a manufactured or refined product.*" (Emphasis added.)

Treasury Regulations 77	*Section 114(b)(4)(B)*
product on the other) than crushing and concentrating (by gravity or flotation).	ment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores.

The sum and substance of the matter is that Congress, agreeing with the view that the approach should be industry-wide, adopted a statutory definition which calls for that approach; it disagreed with existing Treasury practice only in the sense that it concluded that Treasury, in applying its Regulations to certain situations, had failed to treat members of the same class alike. It expressly stated that the statute adopted in 1943 was "in accord with the original regulations and the Bureau practices and procedures thereunder," and was passed "to make certain" that the ordinary treatment processes normally applied by mine owners to obtain a marketable product "should be considered as a part of the mining operation."[45]

(*b*) For the period from 1943 to 1951 (when the last of the minerals allowed percentage depletion under the 1939 Code were added to the statute), taxpayer offers nothing which has bearing on the construction of the statute. It makes no challenge to our showing (App. B, pp. 316–466; chart following p. 500) that, during this period, as reflected in the testi-

[45] S. Rep. No. 627, 78th Cong., 1st Sess., pp. 23–24 (App. B, pp. 210–211).

mony of numerous industry representatives appearing before Congressional committees, the mining industry itself interpreted the statute as allowing depletion on the mineral in the basic form in which it was fit for sale or commercial use.

Taxpayer picks up the thread of the legislative history in 1954, seeking to draw favorable inferences from Congress' failure to enact certain legislative proposals.

In 1954, Congress considered, but failed to enact, a proposal which would have specified the processes which the brick and tile industry might include in the depletion base. Brick and tile cases were then pending in the courts, but none had been decided.[46] The Ways and Means Committee concluded (as stated in

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[46] The first of these cases, *Cherokee Brick & Tile Co.* v. *United States*, 122 F. Supp. 59 (M.D. Ga.), was decided June 4, 1954, and affirmed, 218 F. 2d 424 (C.A. 5th), January 21, 1955.

When percentage depletion was first extended to brick and tile clay in 1951 (along with certain other minerals, including fire clay and shale), the structural clay products industry (which mines and uses brick and tile clay) stated that the statute allowed it depletion on "the market value of the raw materials." *Brick and Clay Record*, Vol. 119, No. 5—November, 1951, p. 24 (App. B, p. 486). Thereafter, in January 1952, it decided that it was entitled to depletion on its burnt clay products because "[r]aw brick and tile clay does not have a commercially marketable value * * *." *Brick and Clay Record*, Vol. 120, No. 1—January 1952, p. 29 (App. B, p. 490). At the same time, it stated that the situation as to fire clay was "considerably different," because there was "regular commerce" in fire clay, and that "[e]ven those refractory producers who do not normally buy or sell such raw material will probably be required to establish a price for the self-mined materials." *Id.* (App. B, p. 487).

a press release, dated February 24, 1954, quoted at p. 97 of taxpayer's brief) that it would leave the matter "to be determined under existing law."

Taxpayer also finds significance (Br., pp. 98–104) in the fact that Congress has not acted on recent Treasury proposals, advanced after the Government had lost a series of cases in the courts. In 1958, the Treasury proposed legislation with respect to the brick and cement industries.[47] See Taxpayer's App. II, p. 115. However, no hearings were held and Congress gave no intimation of its views.

In 1959, the Treasury proposed legislation dealing with the cutoff problem for *all* minerals. Taxpayer's App. II, pp. 124–131. Hearings were held on this occasion and a great variety of views expressed. The representative of the American Mining Congress acknowledged that some "recent cases" had gone "beyond the original concept of the percentage depletion deduction * * *."[48] The Ways and Means Committee, how-

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[47] These were the industries involved in the *Merry Brothers* line of cases (*United States* v. *Merry Brothers Brick and Tile Co.*, 242 F. 2d 708 (C.A. 5th), certiorari denied, 355 U.S. 824) and in the *Dragon Cement* case (*Dragon Cement Co.* v. *United States*, 244 F. 2d 513 (C.A. 1st), certiorari denied, 355 U.S. 833).

[48] Mr. Lincoln Arnold, Chairman of the Tax Committee of the American Mining Congress, testified (House Hearings, 1959 (Hearings before the House Committee on Ways and Means on Mineral Treatment Processes for Percentage Depletion Purposes, 86th Cong., 1st Sess.), pp. 70–71):

"In recent cases the courts have ruled that a producer of minerals—as to which the statute does not specifically bar certain processes—may take depletions based on the value of the first commercially marketable product which he produces, without regard to the type of processes required to arrive at such product. This first commercially marketable product test can lead to the

ever, did not write a report. Instead, on January 12, 1960, its Chairman announced that the Committee had "agreed to defer further action on the cutoff point on percentage depletion until the Supreme Court hands down its decision on the *Cannelton* case." [49]

There is thus no warrant for taxpayer's suggestion that Congress has made a determination contrary to the Government's contentions and that the issue is "peculiarly one for legislative judgment" (Br., p.

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result that although two taxpayers are producing the same end-product, and are using identical treatment processes, one of them may be considered as engaged in mining with respect to all of his processes whereas the second, because of the existence of a market in his area at an earlier stage of processing—whether or not he can or does sell any of his products at that stage—may be considered as engaged in mining only until he reaches that earlier stage.

"However, in applying the marketability test, some courts have ruled in effect that if the production from a mineral deposit is sold at various stages of processing and the producer can show that he sold all that he could economically sell at each stage, then the portion sold at each stage is the first marketable product for that portion of the output of the mine, so that there are as many first commercially marketable products as there are stages of processing at which he sells.

"Thus, under this so-called saturation approach, if the taxpayer can overproduce his market at each stage of his processing, all of his processing would qualify as mining for percentage depletion purposes.

"The Mining Congress has reached the conclusion that the marketability test not only allows results which go beyond the original concept of the percentage depletion deduction, but also can produce unintentional discrimination between taxpayers employing the same treatment processes to produce the same end-product."

Taxpayer has filed copies of these Hearings with the Court.

[49] Congressional Record, Daily Digest, January 12, 1960, p. D10.

120). The issue is purely one of statutory interpretation. And if any inference is to be drawn from the "failure-to-enact" history, the inference is that Congress agrees that the existing statute should be authoritatively construed by this Court.

6. Taxpayer states (Br., p. 27) that the Government's position in this litigation is inconsistent with some 54 cases (listed in taxpayer's Appendix II, pp. 173–181). The listing is an indiscriminate one—the cases cited having been decided on various issues—and the statement will not bear analysis.

More than half of the cases listed represent instances in which the courts, accepting the view that there could be no "commercially marketable mineral product" until sales occurred, held that, in the absence of sales, depletion could be taken on all processes employed by the producer in order to obtain the product actually sold. As pointed out above, the *Merry Brothers* rule, which has been widely applied, particularly in the brick and tile field, does not aid this taxpayer. That line of cases does not suggest that the product on which depletion is taken may vary from taxpayer to taxpayer within the same class.

Indeed, the Fifth Circuit where *Merry Brothers* and most of the brick and tile cases were decided has made this explicit. In *Alabama By-Products Corp. v. Patterson*, 258 F. 2d 892 (C.A. 5th), certiorari denied, 358 U.S. 930 (a case not included in taxpayer's list),[50] the taxpayer was a miner of coking

[50] Also missing from taxpayer's list are cases involving percentage depletion on oil and gas. See our main brief, pp. 44–46.

coals, who converted the coal into coke. Taxpayer's coal sales, which were few in number, did not establish the value of the coal because the sales were "forced" sales (p. 899). The court held that the value of taxpayer's coal was to be computed by reference to the representative market price for coal of like kind and grade (as specified in Treasury Regulations). It held further, as against taxpayer's contention that its coal had unique characteristics, that the term "'like kind' is a broad phrase contemplating the distinction between classes of property" (p. 898); that "all bituminous coals are of like kind, or of the same general property classification" (*ibid.*); that, viewed in this light, the sales by other coal producers established a "true market in commerce" (p. 899); and that the representative price established by other miners was binding on taxpayer even though taxpayer, had it sold at that price, would have operated *"at a loss"* (p. 900).[51] Thus, the Fifth Circuit apparently agrees that the test is a class or industry test, and that there is no room for Cannelton's taxpayer-by-taxpayer "profitability" approach.

A second large group of cases in taxpayer's list reflects controversies as to whether a particular process

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[51] The claim of the taxpayer in *Alabama By-Products* was a much more modest one than that advanced by Cannelton. It was not seeking depletion on coke, but was arguing that its coking coals had unique characteristics and that it should be permitted to compute value by a method other than the representative market price (at which price it could not have profitably sold). Under the Regulations, other methods are available to an integrated producer only if there is no representative market price for a "like kind and grade" of the mineral. See our main brief, pp. 95-96.

was or was not one required in order to put the mineral in marketable condition—for example, whether the mineral in question was marketable without grinding, bagging or some other process alleged to be ordinary and necessary. These cases, by and large, do not involve a conflict in approach.

The cases which plainly endorse taxpayer's "profitability" theory are the instant case, the subsequent decisions by the Eighth Circuit in *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398, and *Bookwalter* v. *Centropolis Crusher Co.*, 272 F. 2d 391 (petition for rehearing pending), and several district court decisions now pending on appeal. But see *Alabama By-Products* v. *Patterson*, 258 F. 2d 892 (C.A. 5th), certiorari denied, 358 U.S. 930.

III

UNDER THE GOVERNMENT'S CONSTRUCTION, THE STATUTE MAY BE READILY AND CONSISTENTLY APPLIED

Taxpayer suggests that there are serious difficulties in applying to an integrated producer who engages only in the sale of finished products a rule which would restrict his depletion base to the value of the basic mineral product. The answer is that Treasury Regulations, repeatedly approved by Congress, provide the appropriate methods for such computation.

The problem of restricting an integrated operator to income from the mining property is almost as old as depletion. As early as 1922, Treasury Regulations provided, "If the mineral products are not sold as raw materials but are manufactured or converted into a refined product, then the gross income shall be assumed to be equivalent to the market or field price of

the raw material before conversion" (Treasury Regulations 62, App. B, p. 6). The same principle was followed when percentage depletion was authorized for oil and gas in 1926. See our main brief, pp. 42–44.

When percentage depletion was extended to other minerals in 1932, Treasury, recognizing that not all minerals had the equivalent of a posted field price, adopted somewhat more elaborate regulations—regulations promulgated after extensive conferences with representatives of the mining industry. These Regulations provided that if a taxpayer applied processes other than those designated as allowable, he should compute depletion on one of two bases: (a) if there was a representative market or field price for the basic marketable product *of like kind and grade,* by reference to that price; (b) if not, by excluding from the depletion base the cost of all non-designated processes. Treasury Regulations 77, App. B, pp. 135–136. This was in accord with the understanding of Congress, which had been fully advised that integrated metal miners (who have long been the rule rather than the exception) [52] would be obliged to segregate and exclude the values created by smelting and refining.[53]

In 1940, Treasury modified the Regulations so as to provide that, in the absence of a representative market price, the integrated operator would be required to eliminate both the cost of excluded processing and the profits derived from such processing. Treasury Regulations 103, App. B, p. 145. Although this change was

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[52] Compare taxpayer's assertion (Br., p. 72) that integration is "the rule rather than the exception" for miners of fire clay.

[53] See main brief, pp. 46–58.

challenged by the industry, Congress refused to overrule the Treasury. Main brief, pp. 58–59, 60–64. This method of computation—the so-called "proportionate profits" test—has been in effect ever since.[54]

In 1945, taxpayers were accorded additional latitude. Thus, an integrated miner is now authorized to substitute another method for the "proportionate profits" method if he establishes to the satisfaction of the Commissioner that such proposed method will clearly reflect the gross income from mining. Treasury Regulations 111, main brief, pp. 95–96.

In the District Court, the Government argued that there was sufficient evidence to establish a representative market price for raw fire clay and shale of the kind and grade mined by Cannelton. We have not discussed this evidence in our briefs to this Court, since that issue was never reached below (both the courts below having concluded that the depletable product was sewer pipe). If the case should be remanded and the District Court should thereafter conclude that there is not a representative market price for raw fire clay and shale of like kind and grade, the "proportionate profits" test would apply.[55] Its opera-

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[54] For a discussion of this aspect of the Regulations, see *Alabama By-Products Corp.* v. *Patterson*, 258 F. 2d 892, certiorari denied, 358 U.S. 930. In situations where a taxpayer does not qualify for percentage depletion (compare taxpayer's brief, p. 111, n. 16), cost depletion is available. Section 23(m), main brief, p. 92; Treasury Regulations 111, Section 29.23m–2.

[55] In the District Court, government counsel erroneously stated that the portion of the Regulations prescribing the "proportionate profits" test was no longer in full effect. This mistake was of no consequence inasmuch as the District Court concluded that sewer pipe was the depletable product.

tion is no mystery. Taxpayer says (Br., p. 6) that its mining costs are $2.418 per ton. Presumably it is equally familiar with its non-mining costs. If it be assumed, by way of illustration, that the latter are nine times the former, then the depletion base would be one-tenth the price of sewer pipe (not ten-tenths, as taxpayer now figures it). The precise computation, of course, is one which should be made in the first instance in the District Court.[56]

Taxpayer poses (Br., pp. 112–115) a series of more complicated factual situations, none of which is before this Court. The difficulties presented by these hypothetical cases are not so formidable as they are made to appear. Suppose, for example, that this taxpayer mined two grades of fire clay and that it manufactured a low-grade sewer pipe from the less valuable clay and a high-grade sewer pipe from the more valuable fire clay. Assuming that there were no sales by Cannelton, or representative sales by others, of either grade, the "proportionate profits" method would apply. Since the high-grade sewer pipe would sell for more than the low-grade sewer pipe, use of that method would allow an increment for the higher grade of clay.

Moreover, to the extent that there are situations in which there are no actual sales to provide a guidepost and in which the "proportionate profits" method fails to take adequate account of special conditions or factors, the taxpayer is authorized to invoke a reasonable

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[56] We note parenthetically that the taxpayer has the burden of establishing the value of its fire clay and shale, not the Government.

alternative method of ascribing fair value to the basic mineral product. The only limitation is that such method fairly reflect the taxpayer's gross income from the mining operation in question. Compare the latitude which taxpayers enjoy and traditionally exercise in computing depreciation with respect to other types of capital assets.

To say that the Government's theory leads, in some instances, to the necessity of making constructive computations is perfectly true. And that is inevitably so, under any system of mineral depletion, unless the integrated operator is to be permitted to take depletion on the basis of his finished manufactured products, whatever they may be. Congress may have the power to authorize the absurd economic consequences and the gross and pervasive discrimination which this approach would entail. The evidence is plain that it has not done so.

CONCLUSION

For the reasons set forth in our main brief and those elaborated above, the judgment should be reversed and the cause remanded for further proceedings.

Respectfully submitted.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959

No. 513

UNITED STATES OF AMERICA,
Petitioner,

v.

CANNELTON SEWER PIPE COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE RESPONDENT

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SUPPLEMENTAL MEMORANDUM FOR THE RESPONDENT

I

The Record

There is no dispute as to what the issue is in this case on the merits, if the various arguments now raised by the Government are properly before the Court—on this Record. It is plain, however, that the case now presented to this Court by the Government is very

different from the case which was presented to the District Court.

In the Government's Reply Brief, no reference whatever is made to the Pre-Trial Order of the District Court, approved by counsel for both parties. (R. 263-65; our Main Br. 37-38). This order "controls the subsequent course of the action, unless modified at the trial to prevent manifest injustice." Fed. R. Civ. P. 16. The function of pre-trial is to narrow issues. That function is completely perverted if the Government may nevertheless make wholly new contentions on appeal to the Court of Appeals, and again on appeal to this Court. If allowed, the result would be unfair to the other party who appropriately relies on the Pre-Trial Order in building the Record which is reviewed on appeal.

In its Reply Brief (pp. 3-4), the Government now for the first time specifically attacks two of the Findings of Fact, Nos. 13 and 10 (R. 5), but no exception was taken to these findings in the trial court, nor in the Court of Appeals. The Government does not now question Finding 12 (R. 5) that "There was no market for the fire clay and shale mined by plaintiff" before it was processed into burnt clay products.

The Government's shift appears most strikingly in its contention now presented for the first time in its Reply Brief (pp. 42-43) that the case should now be remanded to the District Court to be decided on the basis of the "proportionate profits" test. As we pointed out in our main brief (p. 112), in the District Court counsel for the Government expressly disclaimed this test, saying that it had been "abrogated"

and "abandoned." The Government now says (Reply Br. 42 n. 55) that this was done "erroneously." But he was the Government's counsel, and his statements shaped the issues before the District Court. The Government should not be allowed to blow cold in the District Court and hot here. It is clearly seeking a second day in court. *Cf. Galt* v. *Commissioner,* 216 F.2d 41, 51 (7th Cir. 1954).

II

Meaning of Commercially Marketable Mineral Product or Products

In our Main Brief (pp. 41-42), we pointed out that the Government was giving an artificial meaning to the key phrase "commercially marketable mineral product or products," and that in effect the Government was writing the term out of the statute. We gave nine references to the Government's original brief (pp. 18, 21, 25, 26, 76, 78, 80, 85, 90) where the Government interpreted the statutory language "commercially marketable" as meaning simply "fit for commercial or industrial use." We demonstrated that the statutory language could not possibly be the equivalent of the Government's substituted term; and that term is not mentioned once in the Government's 45 page reply brief.

Having been driven from an untenable position as to the meaning of "commercially marketable mineral product or products," the Government now seeks, in its reply brief, to substitute other labels for the statutory term. It is hard to find just where the Government now stands, but its reply brief equates "commercially

marketable mineral product or products" with "the commercially valuable constituent of the mine" (pp. 3, 12) and also with the "commercially valuable constituent of the deposit." (p. 11) In Heading II (p. 8) the Government says that the "cutoff" is the "basic mineral product fit for sale or commercial use," and in another place (p. 11) the Government treats the "cutoff" as "that initial point where [the mineral] was in a condition fit for sale or use." Such references to "sale" may appear to give some effect to the concept of marketability, but the use of the disjunctive shows that even the element of saleability would not be necessary to satisfy the Government's latest understanding of "commercially marketable mineral product or products."

The Government's latest phrases have about the same meaning as "gross value at the mine," which are the words used by Congress in 1913, and never since. What Congress did say in the statute now before the Court is "commercially marketable mineral product or products," and all of the Government's phrases—the new ones as well as the old ones—have the simple effect of writing those words out of the statute.

In our Main Brief (pp. 106-107), we pointed out that after the Government lost two cases in which it contended that "commercially marketable" meant "ready for use in manufacture" the Government turned its attention to "mineral product" and argued that a "manufactured" product cannot be a "mineral" product. The Government's argument to that effect was made primarily in the *Dragon Cement*

case in the First Circuit, although it was also made in the *Sapulpa* case in the Tenth Circuit and the *Merry Brothers* case in the Fifth Circuit (our Main Br. 107 & n.5). In the Government's reply brief here (pp. 15-16), there is an apparent attempt to make some use of this old argument based on the concept of "a mineral product," although the Government does not now make the argument as squarely and directly as it presented it to the First Circuit in the *Dragon Cement* case. This whole line of argument was carefully considered and rejected by the First Circuit in that case (Resp. App. II, pp. 23-26) and by the Courts of Appeals in the *Sapulpa* and *Merry Brothers* cases; and it was expressly disclaimed by the Government's counsel in this case in the District Court.[1]

Under Point II(D) of our original brief (pp. 71-76), we argued that even if the "commercially marketable mineral product or products" are to be determined on an industry-wide basis, the judgment should be affirmed since miners of fire clay and shale normally

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[1] In the Government's Pre-Trial Brief in the District Court, it said (p. 6):

> "All the courts rejected this theory and held that what Congress had said was clear and unambiguous and that there was no justification within the statute to restrict the allowance for depletion to a percentage of mining income as distinguished from manufacturing income. [Citing Dragon Cement and Merry Brothers.]
>
> "This case arose because the Internal Revenue Service computed the taxpayer's allowance for depletion on the basis of a proration of profit to the purely mining operation costs. Following the denial of certiorari by the Supreme Court in the *Dragon Cement* and *Merry Brothers* cases, *supra*, the Internal Revenue Service abandoned this theory of computation . . ."

are required to process such minerals into burnt clay products (such as sewer pipe) to make them commercially marketable. The Government gives no answer to this argument in its reply brief. Indeed, in its Reply Brief (pp. 5-6), the Government now withdraws its reliance on the Bureau of Mines' figures, which show, among other things, that *most of the fire clay and shale produced in the country is processed by the miners into burnt clay products.* There is no basis on which the Government can properly deny that the processes which the Cannelton Company applies to its fire clay and shale (crushing, grinding, tempering, shaping, drying, and firing in a kiln) are the ordinary treatment processes *normally* applied by fire clay and shale mine owners and operators in order to obtain the commercially marketable mineral product or products.

III

Legislative History

The Government asserts (Reply Br. 27) that our discussion of the legislative history "fails to meet" the Government's "thesis" that "Congress expressed its determination to establish a cutoff at the point where the basic mineral product is obtainable, and thus to avoid preference of the integrated miner over the non-integrated miner."

What our discussion of the legislative history (Main Br. 76-105) shows is that Congress has always intended that the commercially marketable products rule be used to determine the depletion base and that it has never been concerned with whether a particular proc-

ess may technically convert a "commercially valuable mineral constituent into a new and different product" (Reply Br. 27)—whatever this may mean. Congress has been interested only in whether the process is one normally applied to produce the mine owner's commercially marketable product or products. Our discussion also shows, contrary to the Government's assertion, that Congress has recognized that various miners of the same ore or mineral may have different commercially marketable products. It has recognized this in the case of gold and copper ores, for example, as we stated in our original brief; the error in the Government's attempt to show the contrary is explained in the Appendix to this memorandum (pp. 15-20). Congress has also recognized this in the case of coal, as shown in our original brief; the Government does not even attempt to refute this fact as to coal, but only says (Reply Br. 26 n. 32) that, "In various respects, coal has been the subject of individual consideration by Congress."

To support its position that Congress undertook to provide "an industry-wide cutoff," the Government refers (Reply Br. 28-34) to the Treasury's 1932 regulations and statements by representatives of the mining industry that originally the Treasury, under those regulations, had considered processes such as cyanidation as "equivalent" to concentration. Thus, the Government argues (Reply Br. 28) that Congress wrote Section 114(b)(4)(B) only to insure that those concentration processes would be included in mining "to assure substantial equivalence, not in order to permit

significant variation." It is obvious, however, that cyanidation and leaching as allowed by the statute go beyond concentration as allowed to miners of gold and copper ores who do not apply these processes. As we pointed out in our Main Brief (p. 88), the Treasury justified its practice, begun about 1940, of disallowing these processes on the basis of achieving equality. Now the Government says that Congress reversed this practice by the statute in order to *assure* equality!

The Government also seeks to show (Reply Br. 33-34) the similarity of the 1932 regulations to the statute by setting forth the lists of processes in each. On their face, they show differences, in that the statute lists processes required to make certain types of ores marketable which the regulation did not mention.[2] The Government completely ignores the material before the lists of processes which, as we have shown (at p. 90 of our Main Brief), is entirely different in the regulation and in the statute—and which, as the Government has said (Main Br. 26-27), is the "crucial" part of the statute to be interpreted and applied in this case.

The significant point about the legislative history of

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[2] Thus, sintering is listed in clause (iii) of the statute but is not in the regulation. A number of processes are listed in clause (iv) of the statute that do not appear in the regulation.

The Government takes comfort (Reply Br. 33 n. 44) from the *amicus curiae* brief of the National Coal Association which it says states that the statute "closely parallels" the regulation. This statement, however, is merely quoted from a Treasury statement and is quoted only in support of the *amicus* brief's position as to coal. Since the regulation allowed the processes required to make coal marketable, it is not surprising that the statute lists the same processes.

the 1943 statute is this. It is clear that representatives of the mining industry sought the commercially marketable products rule and that Congress adopted this rule by including in "mining" the "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products."

Turning to the period 1943 to 1951, the Government states (Reply Br. 34) that "taxpayer offers nothing which has bearing on the construction of the statute." We did, however, discuss (at pp. 92-93 of our Main Brief) the only change in that period having any significance, *i.e.*, the addition of "transportation" to the definition of "mining" in 1950 in order to negate a Treasury attempt to modify the commercially marketable products rule.[3] We also (at pp. 95-96 of our Main Brief) exposed an error in the Government's statement of a bit of legislative history in 1949.

The Government also seeks (Reply Br. 35-38) to minimize the fact that, since 1954, Congress has re-

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[3] The Government also states (Reply Br. 17) that our failure to discuss its chart (Gov't App. B, following p. 500) as to "products in relation to which various branches of mining industry sought percentage depletion" shows that "taxpayer has been unable to find a single flaw in this documentation." Actually, the chart is incomplete; quicksilver ores, for example, are omitted. Also, it is not shown that the talc industry sought "fine pulverization" which the Treasury had disallowed as a manufacturing process. House Hearings, 1953, pp. 2035-37, 2041-42 (Gov't App. B, pp. 448-51).

The testimony outlined as to fire clay is discussed in our Main brief (p. 93 n. 45). The testimony outlined as to shale (presented after shale had been granted percentage depletion) involves only a request that the rate for shale be increased and does not relate to the products in relation to which percentage depletion was sought.

In a further effort to show the products in relation to which mineral producers have sought percentage depletion, the Govern-

fused to act on three Treasury attempts to modify or abolish the commercially marketable products rule. It seeks comfort (Reply Br. 36) from the fact that Congress in 1958 held no hearings and "gave no intimation of its views." Does a failure even to hold hearings on a Treasury recommendation give no intimation of Congress' views on the importance of the proposal or the need for legislation in the area? In 1959, hearings were held and the Government states (Reply Br. 36) that "a great variety of views [were] expressed." The Government, instead of discussing the views of members of the Ways and Means Committee, critical of the Treasury's position (Resp. Br. 102-03), quotes at length (Reply Br. 36-37 n. 48) the representative of the American Mining Congress, a group composed primarily of metal mining interests which does not represent the producers of fire clay or shale. All the Government says about the reaction of the Committee is that it "did not write a report" and that it announced, in January, 1960, that it would defer further action until the Court decides this case (Reply Br. 37). Yet the Hearings were held in March, 1959, nine months before this latest announcement. The failure of the Committee to act after the March hearings during the 1959 Session, coupled with the views of Committee members as expressed at the Hearings, hardly shows that the Committee was impressed with the Treasury's criticism of the present law and its proposal to change the law.

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ment cites (Reply Br. 35 n. 46) anonymous articles in the *Brick and Clay Record*, and it indicates that this magazine speaks for the "structural clay products industry." This magazine is a commercial journal; it does not speak for this industry or any segment of it.

IV

Application of the Statute

The Government asserts (Reply Br. 40, Heading III) that "the statute may be readily and consistently applied" under its construction, but it fails to explain how this is so. As far as this case is concerned, it merely says (Reply Br. 42) that the regulation, including the part which Government counsel in the District Court described as "abrogated" and "abandoned" (our Main Br. 112), should be applied. It describes the regulation, but takes no position as to *how* it should be applied here or how the problems in applying it, discussed in our Main Brief (pp. 110-12), should be solved. It prefers to take up these matters in the District Court at a second trial (Reply Br. 42-43).

In our Main Brief (p. 116 and p. 69 n. 22) we explained the facts concerning L. R. Chapman who dug and delivered clay in Kentucky in 1951 for a sewer pipe producer who owned the clay land. We pointed out that Chapman was entitled to no percentage depletion because he did not have an economic interest in the land and that, contrary to the Government's contention, the decision below did not discriminate against him by giving taxpayer a depletion deduction computed on the selling price of its sewer pipe.[4]

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[4] In its original brief (p. 83 n. 83), the Government referred to Chapman as a "miner" in Kentucky who "sold substantial quantities of both fire clay and shale to a sewer pipe manufacturer." We explained in our brief that this "miner" did not "sell" fire clay or shale, but merely performed services in digging and delivering fire clay and shale for the land owner. Now the Government merely

The Government now refers (Reply Br. 10 n. 5) to the fact that, in 1957, taxpayer began to obtain its clay from land leased from Chapman which Chapman digs and delivers to it.[5] It states that this arrangement "documents the proposition that non-integrated miners will not survive if integrated miners may completely pervert the depletion allowance." Actually, lessees with an economic interest have always been entitled to a depletion deduction based on their gross income from the property less the royalties paid (as to which the lessor is entitled to a depletion deduction). How does this pervert the depletion allowance? Chapman, by leasing this land to taxpayer, has gained new digging and hauling business. Assuming he is a "non-integrated" miner, how does the fact that taxpayer's lease gives him additional business show that he cannot "survive"?

V

The 54 Cases

The Government refers to our statement that "the Government's position in this litigation is inconsistent with some 54 cases," and states that the listing of these cases is "indiscriminate," because they involve "various issues." (Reply Br. 38). Actually, as any study

states (Reply Br. 3 n. 1) that he "mined" fire clay and shale (although still stating, Reply Br. 5, that his operations in Kentucky established a "regular and substantial commerce in raw fire clay and shale").

[5] The Government states that taxpayer has leased this land for one dollar. Actually, the lease calls for a consideration of one dollar *plus a royalty per ton* (R. 179), as is common in mineral leases. Taxpayer turned to this source of clay in 1957, at a time when the costs of its underground mine were increasing (R. 68), and after looking for 5 years in both Kentucky and Indiana for a new source of clay. (R. 69-70).

cf these cases will show, each has involved the question of determining what are "the commercially marketable mineral product or products"—the issue which the Government very correctly states (Reply Br. 8) is presented here on the merits. The Government complains (Reply Br. 38) because cases involving the "*Merry Brothers* rule" are included.[6] Yet in its original brief (pp. 18-19, 90-91), the Government twice specifically invited this Court to overrule those cases. It also complains (Reply Br. 39-40) because some of the cases involved "whether a particular process was or was not one required in order to put the mineral in marketable condition . . ." Yet in all of these cases, the Government tried to exclude those particular processes from "mining" on the basis of one or more of the arguments it presents here.

The Government also complains (Reply Br. 38 n. 50, 38-39) because we omitted oil and gas cases and *Alabama By-Products Corp.* v. *United States*, 258 F. 2d 892 (5th Cir. 1958), *cert. denied*, 358 U. S. 930 (1959). The oil and gas cases were omitted because they did

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[6] Elsewhere (Reply Br. 14), in attempting to distinguish the *Merry Brothers* case, the Government says that case "took the view that the total absence of sales of brick clay (as was assumed on the pleadings) enabled producers of that mineral to take brick as the basis of depletion." No such thing was "assumed on the pleadings." The parties in that case entered a stipulation showing what sales there are of brick and tile clay in the country. These sales were small percentage-wise and the court considered them negligible, but it is not true that there was a "total absence" of sales. Furthermore, the record shows that Merry Brothers itself sold a small amount of its own clay for purposes other than making brick and tile. Merry Bros. Brick and Tile Co., 145 F. Supp. 186, 187, 189 (S. D. Ga. 1956), *aff'd*, 242 F. 2d 708 (5th Cir. 1957), *cert. denied*, 355 U. S. 824 (1957).

not involve in any way the interpretation of Section 114(b)(4)(B), the provision here involved, which is not even applicable to oil and gas. *Alabama By-Products* was omitted because it too did not involve the interpretation of Section 114(b)(4)(B) or the determination of the "commercially marketable mineral product or products" of coal. There the taxpayer conceded that its coal was commercially marketable and the only issue was whether its depletion deduction should be computed on the basis of a "representative market or field price" or by use of the proportionate profits method. The case merely held that "taxpayer has failed to meet its burden of proving that there was no representative market or field price for its coals." 258 F. 2d at 900.[7]

Respectfully submitted,

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MAY, 1960.

[7] The Government also misstates (Reply Br. 39) how such price was determined. It says that taxpayer's sales "did not establish the value of the coal because the sales were 'forced' sales" and that the court held "that the value of taxpayer's coal was to be computed by reference to the representative market price for coal of like kind and grade." Actually, the price used was that at which taxpayer sold its coal. This was the figure used on its return. 258 F. 2d at 895. Taxpayer, by an amended complaint, filed after the trial, sought to raise the issue that the market or field price, if one existed, was higher than such price at which it sold. 258 F. 2d. at 895. The court held, however, that such issue was not raised by the claim for refund and refused to consider it. 258 F. 2d at 900-01.

APPENDIX

Treatment Processes

The Government has great difficulty in attempting to answer our argument that Congress has recognized that "the commercially marketable mineral product or products" may be different for miners of the same mineral, as shown by the nature of certain processes expressly listed in the statute as included in or excluded from "ordinary treatment processes." (Resp. Br. 62-63; Resp. App. II, pp. 8-11). The Government concedes (as it must), although somewhat indirectly and in a footnote (Reply Br. 26 n. 32), that Congress has included as "ordinary treatment processes" in the case of coal certain processes which are not always necessary to make coal marketable; it says somewhat lamely (and inconsistently with its stress in its main brief on Congress' penchant for uniformity under the percentage depletion statute) that, "In various respects, coal has been the subject of individual consideration by Congress." (Gov't Reply Br. 26 n. 32).

The Government also concedes that cyanidation, specifically included by the statute as an "ordinary treatment process," yields gold bullion and that this is a different and more processed product than the gold ore concentrate which is the commercially marketable product in the case of gold ore which is smelted. (Gov't Reply Br. 21-22). It seeks to avoid the effect of this necessary concession by contending that Congress never intended to permit the inclusion in "ordinary treatment processes" of the last step in the cyanidation process, in which the gold precipitate is

melted down into bars of bullion and ordinarily with the addition of a flux such as borax.[1] This last step, the Government contends, is not allowable because it goes beyond "beneficiation," which it says is virtually synonymous with "concentration." (Gov't Reply Br. 22-23). It points out that the pre-1943 Treasury Regulations allowed, in the case of metallic ores, "other processes to the extent to which they do not beneficiate the product in greater degree . . . than crushing and concentrating (by gravity or flotation)." (Gov't Reply Br. 23). But the Government ignores two very important things.

First, the definition of "gross income from the property" enacted by Congress in 1943 did *not* adopt the above-quoted restrictive language from the pre-1943 Regulations. Instead, with that language before it, Congress deliberately chose to include in "ordinary treatment processes," in the case of gold and other metallic ores not customarily sold in the form of the crude mineral product, "beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation . . . or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores."

Second, the Government's present argument with respect to the cyanidation of gold is simply contrary

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[1] TAGGART, HANDBOOK OF ORE DRESSING 961 (1927 ed.).

to the way the 1943 statute has always been administered by the Treasury Department.[2]

In its discussion of leaching in its reply brief (pp. 24-25), the Government seeks to avoid our point that leaching yields a different product than copper ore concentrate by arguing that, unless electrolytic deposition (a disallowed process) is used to precipitate the leaching solution, the precipitate must be "sent to the smelter." (Gov't Reply Br. 25). In failing to explain what is done to the precipitate at the smelter, the Government leaves the impression that the leaching precipitate is the equivalent of the copper ore concentrate. This is not correct. The impure copper precipitated by chemical means must be *refined* (a process which is also necessary *after smelting* of ore concentrate), and this may be done "at a smelter," but if the precipitate is subjected to any process which might be considered smelting, it is usually only *converting*, the final stage in the smelting process used for copper ore concentrates.[3]

Aware of its difficulties with cyanidation and leaching, the Government argues that there is a "great gap

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[2] For example, Lincoln Arnold, Chairman, Tax Committee, American Mining Congress, whom the Government quotes extensively in its reply brief (p. 36 n. 48), in the same statement says that "the processes after cyanidation of gold ores in producing the Dore bar" are "recognized as allowable processes under long-standing administrative decisions and practices." House Hearings, 1959, p. 71.

[3] U. S. Bureau of Mines, Dep't of Interior, Materials Survey: Copper, c. II, at 57-58, 25, 34, 46, c. VI, at 21 n.b. (1952); Stoughton and Butts, Engineering Metallurgy 103-104, 301 (1926). Converting is not treated by some authorities as a part of smelting. Stoughton and Butts, *op. cit. supra*, at 92-93.

between the proposition that different processes may result in variation in the purity of minerals extracted and the proposition . . . that a taxpayer, having obtained the valuable constituent of the mineral, may proceed to include further processing employed in order to convert the first valuable product into a new and different one." (Gov't Reply Br. 21). Thus, the Government returns, in substance, to its mining-manufacturing distinction, which it claims not to assert at all, and which it expressly disclaimed in the District Court.

Faced with the argument that many of the included processes listed in the statute involve physical or chemical changes in the mineral, or both, the Government now says (Reply Br. 11, 19) that it is not saying that Congress attempted to draw a line between mining and manufacturing. And yet it still relies upon the argument that " 'Ordinary treatment processes normally applied by mine owners or operators' can hardly be taken to contemplate the inclusion of processes which a mine owner could never normally apply unless he also happened to be something else in addition, *i.e.*, a fabricator or manufacturer." (Gov't Reply Br. 11). It attempts to rationalize this logical inconsistency in its argument by explaining that it simply cannot believe that manufacturing processes are normally applied by mine owners in order to obtain "the valuable constituent of a mine." Therefore, it argues, "manufacturing processes are, as a practical matter, excluded." (Gov't Reply Br. 11-12). It seeks to explain, indirectly, the express inclusion by Congress of such metallurgical processes as cyanidation, leaching,

and the furnacing of quicksilver ores, by saying (Reply Br. 19 & n. 15) that "extractive processes" (even the excluded processes of smelting and refining) are "certainly not manufacturing." The Government has another name for such processes; they "are ordinarily classified as metallurgy." The idea seems to be that metal miners who have to change the crude mineral physically and chemically by complex metallurgical processes to obtain a commercially marketable product are engaged in "ordinary treatment processes" because their manufacturing has a special name, metallurgy; whereas, a clay miner who has to grind and burn his clay in order to sell it has passed over the line and done something which is "fabrication" or "manufacturing" and not "mining" because, even though he could not sell it, he already had "something of value." (Gov't Reply Br. 19).

It is not true, as the Government suggests, that "the only situation in which taxpayer would give effect to the words 'ordinary treatment processes' is where a taxpayer, having obtained one product which he could sell at a profit, proceeds to go further in order to obtain a still more valuable product." (Gov't Reply Br. 18 n. 14). As explained in our main brief (p. 57), we recognize that the words "ordinary" and "normally" and the plural reference to "mine owners or operators" restrict "mining" in the case of this taxpayer to those processes actually applied to obtain its commercially marketable products which are the *ordinary* treatment processes *normally* applied *by mine owners or operators* in order to obtain those products. Furthermore, as

pointed out in our main brief (pp. 71-76), even if the words of the statute should be construed as implying an industry-wide test, the question would be what processes mine operators *normally* and *usually* apply to obtain their commercially marketable products, not, as the Government contends, what processes are "normal for miners, *qua* miners." (Gov't Br. 8).

SUPREME COURT OF THE UNITED STATES

No. 513.—October Term, 1959.

United States of America, Petitioner, *v.* Cannelton Sewer Pipe Company.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[June 27, 1960.]

Mr. Justice Clark delivered the opinion of the Court.

This income tax refund suit involves the statutory percentage depletion allowance to which respondent, an integrated miner-manufacturer of burnt clay products from fire clay and shale, is entitled under the Internal Revenue Code of 1939.[1]

The percentage granted by the statute is on respondent's "gross income from mining." It defines "mining" to include the "ordinary treatment processes normally applied by mine owners . . . to obtain the commercially marketable mineral product or products." Respondent claimed that its first "commercially marketable mineral product" is sewer pipe and other vitrified articles. Alternatively, it contended that depletion should be based on the price of 80 tons of ground fire clay and shale actually sold during the tax year in question. The District Court agreed with respondent's first claim. The Court of Appeals affirmed, holding that respondent could not profitably sell its raw fire clay and shale without processing it into finished products, and that its statutory percentage depletion was therefore properly based on its gross sales

[1] The applicable provisions of the Code are § 23 (m) and § 114 (b)(4). In general, they provide for a depletion allowance based on a percentage of "gross income from mining," which is specifically defined. See note 8, *infra*. The percentage permitted on shale is 5%, and on fire clay, 15%.

of the latter. 268 F. 2d 334. The Government contends that the product from which "gross income from mining" is computed is an industry-wide test and cannot be reduced to a particular operation that a taxpayer might find profitable. The Government further argues that, while the statute permits ordinary treatment processes normally applied by miners to the raw product of their mines to produce a commercially marketable mineral product, it does not embrace the fabrication of the mineral product into finished articles. In view of the importance of the question to taxpayers as well as to the Government, we granted certiorari. 361 U. S. 923. We disagree with respondent's contention that the issue is not presented by this record, and we therefore reach the merits. We have concluded that, under the mandate of the statute, respondent's "gross income from mining" under the findings here is the value of its raw fire clay and shale, after the application of the ordinary treatment processes normally applied by nonintegrated miners engaged in the recovery of those minerals.[2]

I.

During the tax year ending November 30, 1951, the respondent owned and operated an underground mine from which it produced fire clay and shale in proportions of 60% fire clay and 40% shale. It transported the raw mineral product by truck to its plant at Cannelton, Indiana, about one and one-half miles distant. There it processed and fabricated the fire clay and shale into vitrified sewer pipe, flue lining and related products. In this process, the clay and shale is first ground into a pulverized form about as fine as talcum powder. The

[2] The quantity of ground and bagged fire clay and shale actually sold is too negligible to furnish an appropriate basis for computing depletion.

powder is then mixed with water in a pug mill and becomes a plastic mass, which is formed by machines into the shape of the finished ware desired. The ware is then placed in dryers where heat of less than 212° is applied to remove all of the water. This process takes from 12 hours to 3 weeks, depending on the size of the ware. Thereafter the ware is vitrified in kilns at 2,200° Fahrenheit, requiring from 60 to 210 hours. It is then cooled, graded and either shipped or stored.

Not all clays and shales are suitable for respondent's operations. They must have plasticity, special drying qualities and be able to withstand high temperatures. Respondent's clay, known as Cannelton clay, is the deepest clay mined in Indiana and, respondent says, yields the best sewer pipe. Its cost of removing and delivering the same to its plant was $2.418 per ton in 1951. Respondent used some 38,473 tons of clay and shale in its operations that year and sold approximately 80 tons of ground fire clay and shale in bags at a price of $22.88 per ton. Net sales of its finished wares amounted to approximately one and a half million dollars.

In connection with its tax assessment for the year in question, respondent filed a document in which it stated that "we used as a basis for calculating the gross income from our mining operations of shale and fire clay the point in our manufacturing operations at which we first arrive with a commercially marketable product, which is ground fire clay. This product arrives after the raw mineral is crushed and granulated to such extent that by the addition of water it can be made into a mortar for use in laying or setting fire or refractory brick. This ground fire clay has a definite market and an ascertainable market value at any particular time and is the same product from which our end product, sewer tile, is made simply by the addition of water and the necessary baking process." In this return it based the value of the ground

fire clay at $22.81 per ton, the price for which it sold some 80 tons of that material in bags during 1951. At this figure the depletion allowance would have been slightly above $2 per ton. Thereafter respondent claimed error and asserted that its mineral product, rather than being commercially marketable when it reached the stage of ground fire clay, only became commercially marketable when it became a finished product, *i. e.*, sewer pipe. On this basis, the depletion allowance on petitioner's gross income would be approximately $4 per ton, since the mineral would have a value of about $40 per ton. On the other hand, if the mineral it used in 1951 was valued at $1.60 to $1.90 per ton, the going price elsewhere in Indiana, the depletion allowance would be approximately 20¢ per ton.

The record shows and the District Court found that in 1951 there were substantial sales of raw fire clay and shale in Indiana, mostly in the vicinity of Brazil, about 140 miles from Cannelton. The average price there was $1.60 to $1.90 per ton for fire clay and $1 per ton for shale. Transportation costs from Brazil to Cannelton ran from $4.58 to $5.50 per ton. In Kentucky, across the river from respondent's plant, it appears that fire clay and shale of the same grade were mined and sold [3] before dur-

[3] The evidence indicates that, for $50, Owensboro Sewer Pipe Company bought from L. R. Chapman five acres of ground under which the shale and clay deposits lay. Contemporaneously it made a contract with L. R. Chapman, Inc., to mine and deliver shale and fire clay from this tract to the Owensboro plant for $1.40 per ton. Chapman also testified that in addition he furnished shale and fire clay to other manufacturers in the same area in Kentucky. The arrangements varied. Some were similar to the Owensboro agreement, while others were leases on a royalty basis with a contemporaneous agreement to mine and deliver the clay at a set price. The exact year or years are not clear, but appear to have been between 1949 and 1956. Respondent began using shale and fire clay from the same source by lease arrangement in 1957. The reason for lease arrangements and

ing and subsequent to 1951. In fact, since 1957 respondent has secured all of its mineral requirements from this source on a lease basis under which the lessor mines and delivers the raw material to its plant. The exact cost is not shown, but the haul in 1957 from pit to plant, including the ferry crossing, was some seven miles.

II.

We have carefully studied the legislative history of the depletion allowance, including the voluminous materials furnished by the parties, not only in their briefs but in the exhaustive appendices and the record.[4] We shall not burden this opinion with its repetition.

In summary, mineral depletion for tax purposes is an allowance from income for the exhaustion of capital assets. *Anderson* v. *Helvering*, 310 U. S. 404 (1940). In addition, it is based on the belief that its allowance encourages extensive exploration and increasing discoveries of additional minerals to the benefit of the economy and strength of the Nation. We are not concerned with the validity of this theory or with the statutory policy. Our sole function is application of the congressional mandate. A study of the materials indicates that percentage depletion first came into the tax structure in 1926, when the Congress granted it to oil and gas producers. The percentage allowed was based on "gross income from the property," which was described as "the gross receipts from the sale of oil and gas as it is delivered from the property." Preliminary Report, Joint Committee on Internal Revenue Taxation, Vol. I, Part 2 (1927). The report continued that, as to the integrated

paper transfer of title is not shown. However, Chapman testified that the manufacturers "didn't seem to want to do the prospecting or the sampling until they were sure they could get either a lease or a deed."

[4] The briefs cover 294 pages and the appendices an additional 685, not including 10 charts. The record is 276 pages.

operator, "the gross income from the property must be computed from the production and posted price of oil, as the gross receipts from a refined and transported product can not be used in determining the income as relating to an individual tract or lease." The Treasury Regulations confirmed this understanding. Treas. Reg. 74 (1929 ed.), Arts. 221 (i), 241.

Thereafter, in 1932, percentage depletion was extended to metal mines, coal, and sulphur. The mining engineer of the Joint Committee, Alex R. Shepherd, urged in a report to the Congress [5] that depletion for metal mines be computed, as in the oil and gas industry, on a percentage-of-income basis, and the Revenue Act of 1932 was so drawn. The Shepherd Report pointed out that the percentage basis for oil and gas depletion had been in force for over a year and had "functioned satisfactorily both from economical and administrative viewpoints and without loss of revenue." It added that "careful study of this method as applied to metal mines indicates that the same results will be attained in practice as in the case of oil and gas," but that, because of varied practices in the mining industry, it would be necessary to determine "the point in accounting at which" gross income from the property mined could be calculated. It recommended that "it is logical to peg 'gross income from the property' f. o. b. cars at mine," *i. e.*, net smelter returns, recognizing that processing beyond this point should not be included in calculating "gross income from the property." While as to certain metals, *viz.*, gold, silver, or copper, the report suggested that gross income should be based on receipts from "the sale of the crude, partially beneficiated or refined" product, this was but to make

[5] Preliminary Report on Depletion, Staff Report to the Joint Committee on Internal Revenue Taxation (1930), Appendix XXXI (Shepherd Report).

provision for the specific operations of miners in those metals. In this regard the report also proposed that the depletion base "in the case of all other metals, coal and oil and gas, [should be] the competitive market receipts, or its equivalent, received from the sale of the crude products, or concentrates on an f. o. b. mine, mill, or well basis."

The Congress in fashioning the 1932 Act took into account these recommendations of the industry. It incorporated a provision in the Act allowing percentage depletion for coal and metal mines and sulphur, based on the "gross income from the property." § 114 (b)(4), Revenue Act of 1932, 47 Stat. 169. On the following February 10, 1933, the Treasury issued its Regulation 77, which defined "gross income from the property" as "the amount for which the taxpayer sells (a) the crude mineral product or (b) the product derived therefrom, not to exceed in the case of (a) the representative market or field price . . . or in the case of (b) the representative market or field price . . . of a product of like kind and grade from which the product sold was derived, before the application of any processes . . . with the exception of the processes listed. . . ." Treas. Reg. 77, Art. 221 (g). These exceptions listed processes normally in use in the mining industry for preparing the mineral as a marketable shipping product. The regulation was of unquestioned validity and, in 1943, at the instance of the industry, the Congress substantially embodied it into the statute itself, 58 Stat. 21, 44, including the basic definition of the term "gross income from the property."[6] Since that time the

[6] See, *e. g.*, Hearings before Senate Committee on Finance on H. R. 3687, 78th Cong., 1st Sess. 528; S. Rep. No. 627, 78th Cong., 1st Sess. 23–24; Hearings before House Committee on Ways and Means on Revenue Revisions, 80th Cong., 1st Sess., part 3, at 1857; Hearings before Senate Committee on Finance on H. R. 8920, 81st Cong., 2d Sess. 771; S. Rep. No. 2375, 81st Cong., 2d Sess. 52–53.

section on percentage depletion—§ 114 (b)(4)(B) of the 1939 Code—has remained basically the same.[7] Additional minerals have been added from time to time—shale and fire clay in 1951—until practically all minerals are included.

As now enacted, the section provides that "mining" includes "not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products," plus transportation from the place of extraction to the "plants or mills in which the ordinary treatment processes are applied thereto," not exceeding 50 miles.[8] It then defines "ordinary treatment processes"

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[7] The present statute, § 613 of the Internal Revenue Code of 1954, is essentially unchanged.

[8] Internal Revenue Code of 1939, § 114 (b)(4)(B):

"*Definition of Gross Income from Property.*—As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term 'ordinary treatment processes,' as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily

by setting out specifically in four categories those covering some 17 named minerals. Fire clay and shale are not within these specific enumerations. The Government, however, contends that they should come within clause (iii) of the section, which provides that, "in the case of iron ore, bauxite, ball and sagger clay, rock asphalt *and minerals which are customarily sold in the form of a crude mineral product*—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment . . ." are included in "ordinary treatment processes." (Italics added.) Clause (iv) lists specific metals such as lead, zinc, copper, etc., "and ores which are not customarily sold in the form of crude mineral product," and specifically excludes from the permissible processes certain ones used in connection with these metals. To recapitulate, the section contains four categories of dealing with "ordinary treatment processes": the first enumerating those permissible as to the mining of coal; the second, as to sulphur; the third, as to minerals customarily sold in the form of the crude mineral product; and the fourth, as to those minerals not customarily so sold. We note that the Congress even states the steps in each permissible process, and in addition specifically declares some processes not to be "ordinary treatment" ones, *viz.*, "electrolytic deposition, roasting, thermal or electric smelting, or refining." Furthermore, none of the permissible

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sold in the form of crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of section 450 and 453." 26 U. S. C. (1952 ed.) § 114.

processes destroy the physical or chemical identity of the minerals or permit them to be transformed into new products.

From this legislative history, we conclude that Congress intended to grant miners a depletion allowance based on the constructive income from the raw mineral product if marketable in that form, and not on the value of the finished articles.

III.

The findings are that three-fifths of the fire clay produced in Indiana in 1951 was sold in its raw state. This indicates a substantial market for the raw mineral. In addition, large sales of raw fire clay and shale were made across the river in Kentucky. This indicates that fire clay and shale were "commercially marketable" in their raw state unless that phrase also implies marketability at a profit. We believe it does not. Proof of these sales is significant not because it reveals an ability to sell profitably—which the respondent could not do—but because the substantial tonnage being sold in a raw state provides conclusive proof that, when extracted from the mine, the fire clay and shale are in such a state that they are ready for industrial use or consumption—in short, they have passed the "mining" state on which the depletion principles operates. It would be strange, indeed, to ascribe to the Congress an intent to permit each miner to adopt processes peculiar to his individual operation. Depletion, as we have said, is an allowance for the exhaustion of capital assets. It is not a subsidy to manufacturers or the high-cost mine operator. The value of respondent's vitrified clay products, obtained by expensive manufacturing processes, bears little relation to the value of its minerals. The question in depletion is what allowance is necessary to permit tax-free recovery of the capital value of the minerals.

Respondent insists that its miner-manufacturer status makes some difference. We think not. It is true that the integrated miners in Indiana outnumbered the nonintegrated ones. But in each of the three basic percentage depletion Acts the Congress indicated that integrated operators should not receive preferred treatment. Furthermore, in Regulation 77, discussed above, the Treasury specifically provided that depletion was allowable only on the crude mineral product. And, as we have said, this regulation was substantially enacted into the 1943 Act. We need not tarry to deal with any differences which are said to have existed in administrative interpretation, for here we have authoritative congressional action itself. Ever since the first percentage depletion statute, the cut-off point where "gross income from mining" stopped has been the same, *i. e.*, where the ordinary miner shipped the product of his mine. Respondent's formula would not only give it a preference over the ordinary nonintegrated miner, but also would grant it a decided competitive advantage over its nonintegrated manufacturer competitor. Congress never intended that depletion create such a discriminatory situation. As we see it, the miner-manufacturer is but selling to himself the crude mineral that he mines, insofar as the depletion allowance is concerned.

IV.

We now reach what "ordinary treatment processes" are available to respondent under the statute. As the principal industry witness put it at hearings before the Congress: "Obviously it was not the intent of Congress that those processes which would take your products and make them into different products having very different uses should be considered, as the basis for deple-

tion."[9] But respondent says that the processes it uses are the ordinary ones applied in the industry. As to the miner-manufacturer, that is true. But they are not the "ordinary" normal ones applied by the nonintegrated miner. It was he whom the Congress made the object of the allowance. The fabrication processes used by respondent in manufacturing sewer pipe would not be employed by the run-of-the-mill miner—only an integrated miner-manufacturer would have occasion to use them.

Respondent further contends, however, that it must utilize these processes in order to obtain a "commercially marketable mineral product or products." It points out that its underground method of mining prevents it from selling its raw fire clay and shale. This position leads to the conclusion that respondent's mineral product has no value to it in the ground. If this be true, then there could be no depletion. One cannot deplete nothing. On the other hand, respondent alleges that its minerals "yield the best sewer pipe which is made in Indiana." If this be true, then respondent's problem is one purely of cost of recovery, an item which, as we have said, has nothing to do with value in the depletion formulae. Depletion, as we read the legislative history, was designed not to recompense for costs of recovery but for exhaustion of mineral assets alone. If it were extended as respondent asks, the miner-manufacturer would enjoy, in addition to a depletion allowance on his minerals, a similar allowance on his manufacturing costs, including depreciation on his manufacturing plant, machinery and facilities. Nor do we read the use by the Congress of the plural word "products" in the "commercially marketable" phrase as indicating that normal processing techniques might include the fabrication of different products from the

[9] Robert M. Searls, Attorney, San Francisco. Silver Subcommittee Hearings, 1942, p. 764.

same mineral. We believe that the Congress was only recognizing that in mining operations often more than one mineral product was recovered in its raw state.

In view of the finding that substantial quantities—in fact, the majority—of the tonnage production of fire clay and shale were sold in their raw state, we believe that respondent's mining activity during the year in question would come under clause (iii) of the section here involved. That clause includes "minerals which are customarily sold in the form of a crude mineral product." We believe that the Congress intended integrated mining-manufacturing operations to be treated as if the operator were selling the mineral mined to himself for fabrication. It would, of course, be permissible for such an operator to calculate his "gross income from mining" at the point where "ordinary" miners—not integrated—disposed of their product. All processes used by the nonintegrated miner before shipping the raw fire clay and shale would under such a formula be available to the integrated miner-manufacturer to the same extent but no more.

Nor do we believe that the District Court and Court of Appeals cases involving percentage depletion and cited by respondent are apposite here.[10] We do not, however, indi-

[10] Respondent's cases are based on *United States* v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 (adhered to in *United States* v. *Merry Bros. Brick & Tile Co.*, 242 F. 2d 708), which went off on factual concessions not present here. They have been pyramided into a statistically imposing number of cases, predicated upon one another. Close analysis indicates that they either go off on concessions or findings not present here, or deal with controversies over particular treatment processes claimed as "ordinary" in the industry involved. For our purposes, we need not reach the question of whether in those cases the minerals in place had any "value" to be depleted. Other than the decision here under review, only two of the Court of Appeals cases cited by respondent, both from the same Circuit (*Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398; *Bookwalter* v. *Centropolis Crusher Co.*, 272 F. 2d 391), adopt the profitability test, which we find unacceptable.

cate any approval of their holdings. It is sufficient to say that on their facts they are all distinguishable.

In view of these considerations, neither of respondent's alternate claims for depletion allowance is appropriate. The judgment of the Court of Appeals is therefore reversed, and the cause remanded for further proceedings in conformity with this opinion.

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 513.—October Term, 1959.

United States of America, Petitioner, *v.* Cannelton Sewer Pipe Company.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[June 27, 1960.]

Mr. Justice Harlan, concurring in the result.

In joining the judgment in this case I shall refer only to one matter which, among the voluminous data presented by the parties, is for me by far the most telling in favor of the Government's position.

Treasury Regulation 77, promulgated in 1933 under the Revenue Act of 1932 (47 Stat. 169), defined the basic term "gross income from the property" contained in § 114 (b)(4) of the 1932 Act and carried forward in its successors. Art. 221 (g). It concededly supports, by its express terms (see *ante*, p. ——), the position of the Government in the present case. In my opinion the regulation was undoubtedly a valid exercise of the Commissioner's power to construe a generally worded statute. See Preliminary Report on Depletion, Staff Reports to the Joint Committee on Internal Revenue Taxation (1930), p. 68 (Shepherd Report); *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 102–103. The Revenue Act of 1943 (58 Stat. 21, 45), which added to the 1939 Code the provisions governing this case, represented only a limited departure from the 1933 Regulation, or from the administrative action taken under it, principally in the area of extractive processes applied to minerals not customarily sold in the form of a crude product, and did not basically affect the meaning of the term "gross income from the property." See, *e. g.*, Revenue Act of 1943, Hearings

before the Senate Committee on Finance, 78th Cong., 1st Sess., on H. R. 3687, pp. 527–529; S. Rep. No. 627, 78th Cong., 1st Sess., pp. 23–24; Revenue Revision of 1942, Hearings before the House Committee on Ways and Means, 77th Cong., 2d Sess., p. 1202; compare *id.*, at 1199; Silver, Hearings before the Senate Special Committee on the Investigation of Silver, 77th Cong., 2d Sess., pursuant to S. Res. No. 187 (74th Cong.), pp. 761–764. Respondent's efforts to impugn the force of that regulation, see Shepherd Report, *supra*, at 70, 71; Revenue Revisions, 1947–1948, Hearings before the House Committee on Ways and Means, 80th Cong., 1st Sess., p. 3283; Mineral Treatment Processes for Percentage Depletion Purposes, Hearings before the House Committee on Ways and Means, 86th Cong., 1st Sess., pp. 258, 264, seem to me quite unpersuasive.

This history, in my view, provides an authoritative and controlling gloss upon the term "commercially marketable mineral product or products" in the statutory definition of "mining," which in turn constitutes the "property" with which the statute deals. See *Helvering* v. *Wilshire Oil Co.*, *supra*. It results, on this record, in limiting respondent's basis for depletion to its constructive income from raw fire clay and shale.